TRANSFER TAXES: THEIR EFFECT ON PRODUCTIVITY AND CONTROL OF OUR ECONOMY

Governments can procure resources only through the initiative, the labour and the savings of individuals. —Adam Smith

prepared by
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and
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for the
ONTARIO ECONOMIC COUNCIL
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ACKNOWLEDGEMENTS

John K. Savage, of Toronto, a graduate of the University of British Columbia in Commerce and Business Administration, is a fiduciary consultant in personal and corporate financial planning, a member of the Estate Planning Council of Toronto and the Canadian Tax Foundation.

Mr. Savage contributed "An Analysis of Transfer Taxes: Their Social and Economic Derivation and Consequences", reproduced as Section 2 of the report. In addition, he provided invaluable assistance in combining Canadian and United States data with that supplied in the Van Den Bulcke study to make possible the comparative analyses in Section 1.

D. Van Den Bulcke is an economics graduate of the University of Ghent who first came to Canada in 1962 to conduct a study for the Belgian Office of Foreign Trade on "Canada and the British Decision to Join the Common Market." He returned to the University of Toronto to obtain an M.A. degree in 1965-66 on a Council of Arts scholarship. He was appointed as departmental assistant at Ghent in 1963.

The Ontario Economic Council was fortunate in obtaining Mr. Van Den Bulcke's consent, while at the University of Toronto, to compile the study of the systems of transfer taxation of the nations of Western Europe, reproduced as Section 3.

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Reading Guide

Section 1 (the buff pages) contains an initial review of the highlights of the report and its recommendations.

Thereafter Section 2 and the summary of Section 3 (pages 69 to 74) add supporting information.

For those whose interest extends to the individual European systems the Van Den Bulcke report (Section 3) provides a more detailed record.

AIMS OF THE STUDY

1. To establish the nature and degree of the impact of transfer taxation on the development in Ontario of privately-owned businesses;

2. To examine the extent to which the current administration of transfer taxation in this province involves inequities, or has failed to fulfill its original stated purpose of preventing undue concentrations of wealth; and

3. To make such recommendations, as may, in the light of the experience of this province and of other jurisdictions in this field of taxation, increase equity of application and inspire formation of additional capital and its productive employment within the Canadian economy.

TRANSFER TAXES: A DEFINITION

Transfer Taxes in the definition of this study are taxes levied on property given or bequeathed by an individual to his heirs, and include gift taxes, death, inheritance, estate and succession taxes or duties.

A gift tax is charged upon a gift or transfer of assets between living persons i.e., inter vivos, and is generally charged against the giver, although the receiver frequently shares liability for its payment.

Estate or death taxes and duties are levied against the property of the deceased.

Inheritance or succession taxes and duties are levied against the property bequeathed to the inheritor.

Rates of an estate or death tax are based on the total value of a deceased's estate. A pure inheritance or succession tax is based on the value of the property inherited by individual heirs, and usually relates to the relationship of the heir to the deceased. Immediate relatives enjoy a lower tax rate than those more remote, the maximum rate being applied to bequests to strangers or non-relatives.

The "succession duty" imposed in Ontario by the Succession Duty Act is neither an estate tax nor a pure inheritance tax. Rates of duty are determined by adding an estate tax schedule to an inheritance tax schedule, both requiring consideration of the relationship of the inheritor to the deceased, and applying the sum of the rates to the value of the property to be received. To the product of this calculation is added an additional tax (surtax), the rate again being subject to the relationship.

FOREWORD

Any individual tax, as well as any tax system, is a product of social, economic, political and legal factors arising from beliefs, pressures and biases assembled over many years.

Tracing such history is not an objective of this study, except where better understanding may so demand. Rather its over-all purpose is to examine these factors in relation to death taxation in general, and to The Estate Tax Act (Canada) and The Succession Duty Act (Ontario) in particular.

Learned critics over many years have debated the pros and cons of transfer taxes. Such critics have almost invariably been men of law concerned primarily with the justice or impartiality represented rather than with economic consequences.

Undue concentration of wealth resulting from a complete absence of transfer taxes tends to destroy incentives which contribute to productivity.

Over-imposition of transfer taxes, on the other hand, has the same effect, not only by reducing the national urge to save and build, but by contributing to the loss of control of the nation's material resources.

Obviously, there must be a mid-position. What is it and how closely do our practices approach it?

Most Canadians agree readily with the need for economic growth; and economic growth, to them, is interpreted as employment—more employment, more rewarding employment, and more stable employment.

Such economic growth is dependent upon investment.

The bulk of the tax revenues of Western nations proceeds from the taxation of income and consumption.

Transfer taxes, however, are taxes levied upon accumulations of capital, i.e. investment. As such, they naturally influence significantly the behavior of the individuals bearing the brunt of the tax.

Such reaction is most pronounced among individuals most highly taxed—the very persons who influence in highest degree the course of the country's economic development. And these are, in the main, Canadian citizens or residents of Canada.

That we must seek assistance from abroad in the development of our resource and secondary industries is widely recognized as essential to our national growth. But, if we are to benefit to the greatest extent from such development, it would seem at least equally essential that we should stimulate and encourage our domestic sources of capital.

Canada has long been known as a stable and productive investment area for risk capital from abroad. The resulting large inflow of share or "equity" capital has provoked the cry from many responsible Canadians that control of Canadian enterprise is passing forever into the hands of such foreign investors.

And, of course, it is true that our economy is increasingly dominated by foreign investors. It is equally true, however, that transfer taxes, particularly when imposed at the death of a Canadian investor, influence the sale of many Canadian-owned businesses to foreign investors. The foreign investor possesses a distinct advantage over a Canadian would-be investor since acquisitions by a privately-owned Canadian company serve only eventually to compound the death tax payments of the new owners.

At the same time foreign nationals of many countries interested in investing part of their capital in Canada are discouraged from establishing a residence and domicile in Ontario because of potential transfer tax penalties which could be levied against their entire estates, wherever situated. Import of both the talent and the capital of such investors should be a desired economic goal of domestic tax policy. An important application of such a policy should involve a minimal structure of transfer tax rates, thus providing an incentive for the talented foreign investor not only to emigrate to Canada but to become a citizen.

The foreign purchaser, normally a public corporation with broad stock distribution, need not be concerned with the impact of Canadian transfer taxes.

The relatively smaller size of the average Canadian company does not permit many such acquisitions within any defined period.

Again, economies of scale available to foreign businesses not only permit them to pay a higher price for acquisitions, but normally facilitate a more ready absorption of a new unit. Such purchasers may also have an established position in the market, and benefit from tax advantages unavailable to Canadians. For example, United States corporations are permitted to deduct as a business expense the cost of funds borrowed to acquire enterprises anywhere in the world.

Some sales to foreign investors are, therefore, inevitable. To accelerate the disposal of Canadian-owned private business to foreign investors, however, through the imposition of transfer taxes upon the value of such business, while assisting the government treasury only to a minor degree, cannot be considered in the best long run interest of the national economy.

Canada is typical of a developing economy, dependent as it is upon substantial capital investment, both domestic and foreign. There are many small private companies still in their early stages of development by their originators. To adhere to a taxation policy which in any way disrupts this development, or the capital represented, penalizes Canadian enterprise. Transfer taxes, as currently applied in Canada appear to represent an economically regressive taxation policy and are worthy of further and immediate review by federal and provincial authorities.

W. H. Cranston
Chairman
Ontario Economic Council

RECOMMENDATIONS

Detailed below are the recommendations made in this report. In each case a reference is provided to the page or pages on which the development of the specific recommendation is found.

With one exception each should be considered as independent of the others. The first recommendation is the only one dependent for its implementation upon an authority other than the government of the province of Ontario, though Recommendation 4 is conditional upon federal acceptance of Recommendation 1.

Recommendation 1 pages 20 and 48

That the federal government be encouraged to review and simplify gift and estate tax legislation for uniform operation by the provinces as a condition for its own withdrawal from the fields of estate and gift taxation.

Recommendation 2 pages 29 and 57

That where more than ten percent of the issued and paid-up capital of a private Canadian corporation possessing assets of which not more than ten per cent are securities of public corporations or government is represented by shares owned by a deceased at the time of his death, the value of such shares be included in determining the rate of transfer tax to be applied to other estate assets, but such value be exempted from transfer tax unless such shares are sold within a period of ten years.

Recommendation 3 page 44

That Ontario continue its policy of not taxing gifts unless the federal government should vacate that field.

Recommendation 4 page 48

That, failing federal adoption of Recommendation 1, Ontario make application to the federal government to qualify as a "prescribed province" in respect to the levying of death taxation in order to increase direct provincial occupancy of the field to 75% and correspondingly reduce federal occupancy to 25% from present levels of equal occupancy.

Recommendation 5 page 50

That Ontario introduce legislation providing for complete interspousal exemption, i.e., that all property passing on death to a surviving spouse be exempt from transfer taxes, but be aggregated with property of the survivor and subjected to transfer taxes at the death of the survivor.

Recommendation 6 page 50

That relationship discrimination be eliminated through adoption of a rate schedule based upon the size of the estate (this could be federally determined), or based upon the size of the bequest but applied over its full period of enjoyment by the heir.

Recommendation 7 page 50

That transfer tax rates applying to the same estate or bequest within a period of five years be reduced by 50% if re-applied within one year, 40% if within two years, 30% if within three years, 20% if within four years and 10% if within five years.

Recommendation 8 page 50

That there be provision for payment of duty by instalment, with interest on the outstanding balance, over a period determined by the size of the bequest, unless rates are applied during the full period of enjoyment.

Recommendation 9 page 56

That legislation be included in a revised Ontario Succession Duty Act to provide for the deferment of duty attributable to timberstands on private woodlots, without interest, provided that neither the property nor the timberstand be sold within ten years of transfer to the donee, and that cutting in that period be limited to normal silvicultural maintenance.

SUMMARY

It is difficult to conceive of an application of taxation policy which could hinder in greater degree the continued development of private business under the direction of domestic entrepreneurs than does the application of transfer taxes to the value of such business upon the death of the entrepreneur.

The relatively small revenue to the treasury of government derived from the levy of transfer taxes upon such private business represents but little return to the economy when compared with the economic effects of its removal from productive private enterprise.

While allegedly aimed at the "redistribution of wealth", these taxes are to a very significant degree extracted from individuals who by today's standards cannot be considered wealthy. Over 75% of dutiable estates are valued at less than $200,000. Yet they contribute 39% of Ontario succession duty revenue. Since liquid assets total approximately 60% of estates valued at less than $500,000, the adoption of the recommendation for the special assessment of estates embodying shares of a private business would cause only minor loss to total Ontario treasury revenues.

The present demand for prompt settlement of transfer taxes in cash penalizes the private industry sector of the economy since that cash must be wrenched from vital working capital. The resultant "sell-out" of such industry generally represents a substantial cost to the provincial economy.

This diversion of risk capital into securities of government and public (and frequently foreign-controlled) corporations as a result of the ensuing "sell-outs" of industry enriches Canada's federal treasury by only one half of one per cent of its net tax revenue and Ontario's by only 3.2%.[1]

Foreign investors of other than a very limited number of nations with whom Canada has tax treaties face substantial barriers in coming to Ontario to invest and work. Their assets in their homeland enterprises could be severely affected in meeting Canadian transfer tax liabilities in case of their death in Canada since federal and Ontario authorities would tax them on the basis of *total assets*, wherever situated.

In addition to the problems of private secondary industry, increased yields and larger volumes of produce contribute to the inclusion of farming operations in the class of businesses subject to transfer taxation. As the economies of large-scale farm operations become more prevalent, and the world demand for food accelerates, are the working capital requirements of our agricultural industry to be compounded by the imposition of substantial transfer taxes on our farms?

Already we are in a position to observe this effect. Assume your home farm, having a value of only $70,000, is willed to your brother. The federal government's assessment against your estate will total $2,200 while your brother will become liable to pay a further $11,382 to the Ontario treasury.

One may well question whether a $70,000 farm represents an "undue concentration of wealth", and whether the object of the "redistribution of wealth", when carried to this degree, is economically sound policy.

But the anomaly has already enlarged unbelievably. The rapidly increasing group in the labour force earning from $10,000 to $25,000 annually with corresponding capacity to save and invest, their growing amounts of life insurance and the inclusion of the commuted value of pensions in their estates upon death—all combined with the rigidity of a long-established succession duty structure, results in the taxation each year of thousands of estates of less than $100,000.

One cannot but conclude that our existing system of transfer taxation tends to be discriminatory inasmuch as it imposes capital levies on estates and bequests of relatively small value while wealthier individuals can, through legal means, minimize tax liabilities.

All Western nations, in varying stages of economic development, levy transfer taxes of one form or another. All have faced the same potential consequences as are presently faced by the Canadian economy. Most, however, have undertaken to shape their transfer tax legislation to the peculiar needs of their respective economies. Such recognition of the need to foster domestic sources of entrepreneurial capital and avoid its dissipation is required within this country, and particularly within the Province of Ontario, if it is to maintain its position as the Province of Opportunity.

(1) During the fiscal year ending in 1967.

COMPARATIVE INTERNATIONAL DATA

Although Canada is not a financial "have" nation (we are net importers, not exporters, of capital), our transfer tax practices class us with the "have capital" nations—the United Kingdom, the United States, and France, though France along with Holland, Belgium and Germany all have relatively much lower total yields from these tax sources.

How does it happen that Canada (perpetually capital-hungry because of her rapid growth rate and the appetite of her citizenry for the abundant life) acts thus to discourage resident or foreign investors?

The fathers of confederation in 1867 saw it essential to ensure a powerful central government in the new Canada. Accordingly, the existing sources of government revenue of that day (almost entirely proceeding from indirect forms of taxation) were established as the prerogative of the federal government. The provincial governments, limited to the field of direct taxation, were as a result severely starved of revenue for almost the next half-century.*

The availability of succession duties in the field of direct taxation was established by Ontario in 1892 and quickly taken up by other provinces. Whether suited to a developing nation or not mattered little; it was a necessary and important source of revenue at that time.

Therefore, whether for Canada it may be a good tax or a bad tax, and regardless of the fact that it is a relatively unimportant source of revenue, it continues to this day.

Despite the lack of similarity in her capital needs in comparison with either the United States or the United Kingdom—and despite the alarming numbers of "sell-outs" of promising Canadian firms and the evident connection with this unimportant revenue source — Canada's attachment to the transfer tax continues, not even modified in its impact by the extended terms of payment provision and the larger personal exemptions which the United States has found desirable.[0]

In Appendix III is reproduced a summary of the tax legislation of ten European countries and the United Kingdom as related to death, estate, inheritance, succession, and gift duties.

In this section of the report are combined some of those findings with comparative data for the United States and Canada.

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* "The Financing of Canadian Federation", the Canadian Tax Foundation, 1966, pp. 1-4. See also p. 47 this report.
[0] See also pp. 14, 17-18, 49-50.

Canada's total income (federal and provincial) from transfer taxation was $182 million (1964-65) and $206 million (1965-66). This latter figure represents 1.8% of the total federal and provincial income from all taxation for that year as shown in the chart below.

In Tables XIII and XIV of Appendix III is summarized the impact of death, succession and gift taxes in the United Kingdom and in various European nations in net percentage charges against estates of varying size.

On the following two pages those data are represented in graphic form, with the addition of similar facts for the United States and Canada.

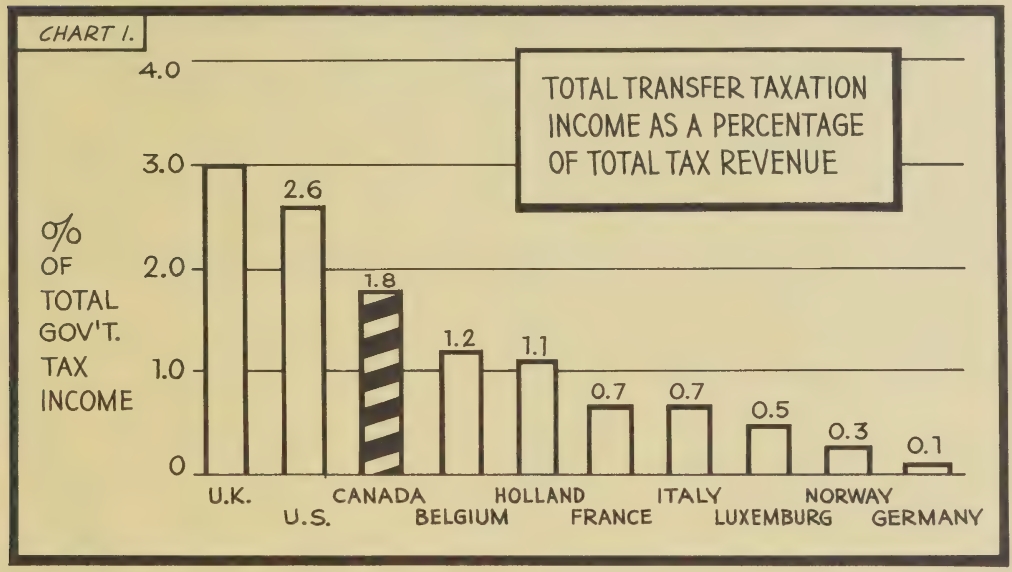
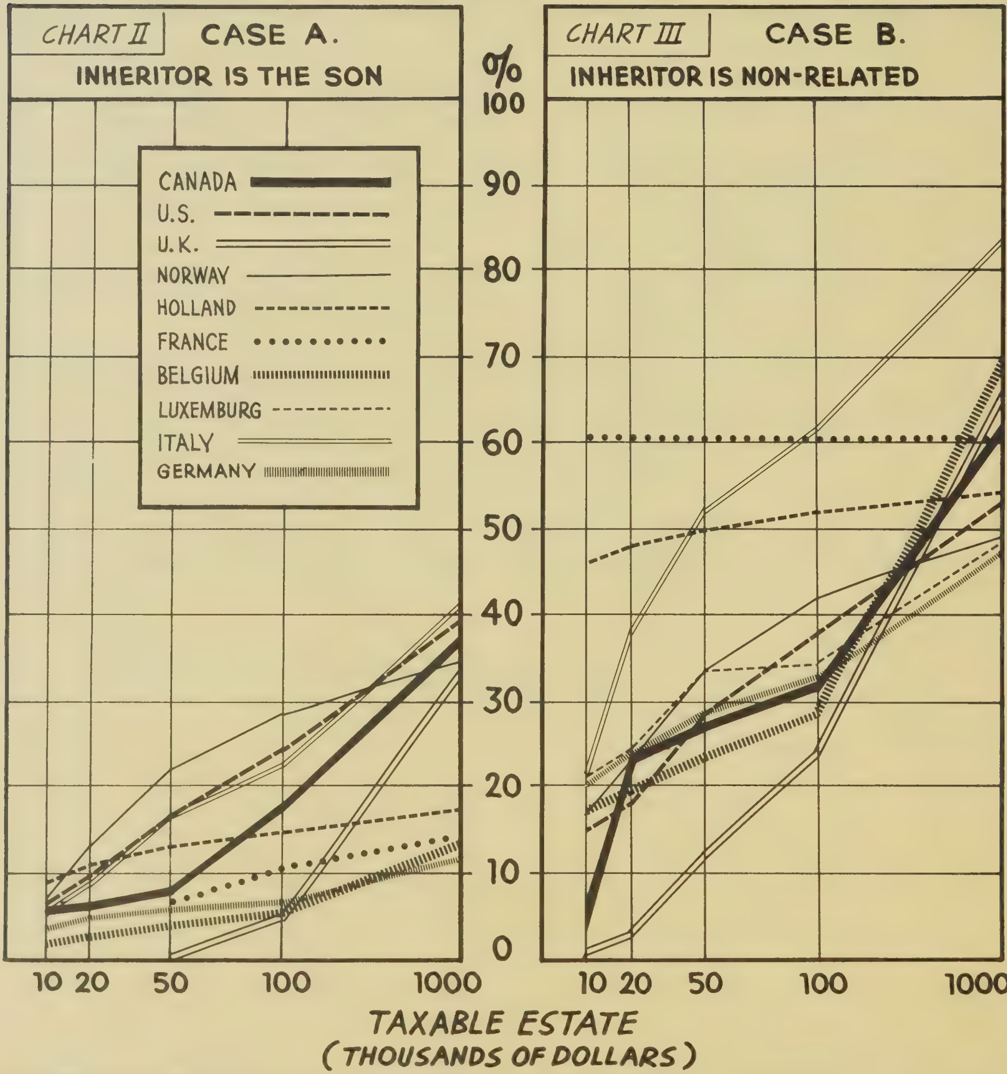


Chart I data from the following sources:
Canada — (Total of federal and provincial transfer tax income) Budget Papers, Appendix HANSARD Vol. III, No. 51, 1st Session 27th Parliament, p. 121 — (Can. Tax Foundation) Provincial Finances, 1965, p. 12 and No. 39 Provincial Finances 1965-1966
United States — (Total of federal and state transfer tax income) U.S. Bureau of the Census Statistical Abstract (1965) — Table No. 567
Other countries — 1959 data. See Section 3, p. 69.

In the charts below Canada appears generally in mid-position relative to the other nations, and corresponding fairly closely to the United States pattern. But it is worthy of note that Canada's rates are much higher than those of the United Kingdom, with the exception of the high rates imposed in both countries upon bequests to non-related heirs.

PERCENTAGE OF TAXABLE ESTATES PAID IN DEATH, ESTATE, SUCCESSION AND/OR GIFT TAXES

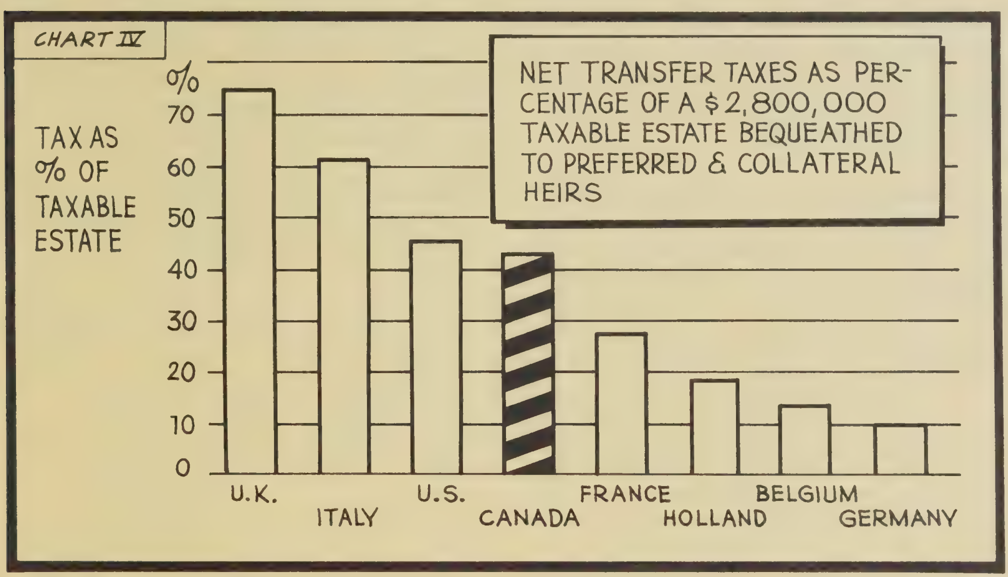


In Table XIII of Section 3 is shown the total transfer taxation applicable to a large estate ($2,800,000 or £1,000,000)* in various countries. In this case 40% of the estate is willed to the widow, 15% to each of three sons, 5% each to three sisters. In other words, these are closely related legatees, not strangers.

That data plus similar analyses for Canada and the United States, is charted below.

Great Britain, the United States and Canada represent a much higher percentage of total taxes than in any other nations shown. France, Italy and Norway collect only relatively small fractions of their total taxes from transfer taxation as compared with the United Kingdom, the United States and Canada.

It should not be overlooked, of course, that when the rigidity of collection characteristic of



United States — (federal) $998,200 + 53% over $2,500,000 less credit of $164,300 = $961,000 or 34.3%. (State of California) $288,400 or 10.3%. Total 44.6%. (See Commerce House, *Internal Revenue Code* 1962 pp. 4453-4455.)
Canada — federal 22.3%, plus Ontario 21.41% = 43.71%. For provinces other than Ontario, Quebec and British Columbia rate is same as for U.S. (i.e., 44.6%).

Again we find Canada's transfer tax practices more closely related to the "have" nations, particularly the United States and the United Kingdom.

Comparing Chart IV with Chart I, while the United Kingdom, the United States and Canada are all in the same relative position, Italy's rates in Chart IV place her ahead of the United States and Canada. But her high rates are sharply reduced in practice by tax avoidance.

Actually these rates in practice are modified out of all recognition by tax avoidance. Reference to chart I on page 11 shows that actual collections in the three last-named countries is viewed in relation to their superior total wealth a much higher total collection is only to be expected.

But one result of the level of Great Britain's estate tax has been the necessity of recent years to enforce restrictions to prevent the flight of capital. Since Canada's tax collections from this source class her with two of the wealthiest of the world's nations, the question again recurrs — are our estate laws designed to chastise or to welcome investors and job-creators?

* Conversions of currencies made prior to 1967 devaluation of British £.

COMPARISON OF TOTAL TRANSFER TAX CHARGES
AUSTRALIA, GREAT BRITAIN, CANADA AND THE UNITED STATES

Chart V is based upon a table provided by Wheatcroft, which has been modified to show the total taxation involved in Canada and the United States, including provincial or state taxation.[1]

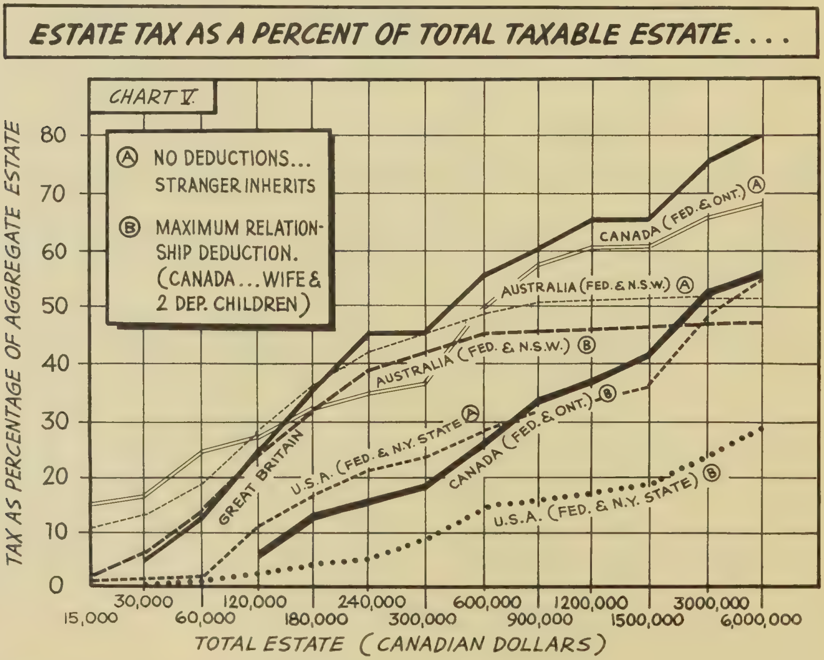
Initially, though of minor interest, is the generally similar pattern of taxation where there are no marital deductions and the estate passes on to a non-relative. The comparatively low rates for the United States are noteworthy.

The important pattern, of course, is that in which bequests pass to immediate family. There is a very wide divergence between the taxes on a bequest to a spouse with dependent children in Canada and a similar bequest in the United States.

The major cause of this difference lies in the concept of community of property between spouses which sets aside from the taxable estate one-half of a bequest to the survivor. This provision is of obvious benefit in lightening the tax impact on a family-controlled business, or a near-controlling interest in a business undertaking.

It must be remembered that such an estate again becomes subject to taxation upon the death of the surviving spouse. The feature is of particular importance where the total amount of property in the family is small. It facilitates leaving all the property to the surviving spouse so that he or she will not become dependent upon their children.

This concept is incorporated in a somewhat similar form in the Quebec Succession Duties Act but in no other provincial jurisdiction.



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[1] "Estate and Gift Taxation" — Wheatcroft, London (Street and Maxwell) 1965. p. 109.

TAXATION OF CAPITAL IN FOURTEEN NATIONS*

Still another approach is to look at the distribution of tax levies as between income, capital and consumption (see table below).

While a complete breakdown of what is considered a tax on capital is not available, the figure for Canada in the second column of the table includes Canada's comparatively heavy municipal real property taxes. This may be an important factor accounting for the fact that Canada, with no acknowledged tax on capital gains (other perhaps than the estate tax and succession duty), emerges with the highest percentage of tax on capital among the countries shown in table below.

The significance of the above comparisons should not be overemphasized, since they contain numerous conceptual differences and cannot be interrelated accurately at this time. In their favour it can be said that they take account of all levels of government, and thus avoid the misleading picture that can be drawn from looking at taxes imposed by only one (usually the national) level of government.

International Comparison of Taxes on Income, Capital and Consumption,
All Levels of Government,
Fiscal Year 1960*a*

	Taxes on Income *b*	Taxes on Capital *c*	Taxes on Consumption *d*
United States	63.5	14.2	22.3
New Zealand *f*	61.8	10.8	27.5
Japan	60.3	6.7	33.0
Netherlands	63.3	3.3	33.3
Switzerland	66.1 *e*		33.9
CANADA	48.8	17.1	34.1
Germany	62.0	3.2	34.8
Sweden *f*	63.3	1.1	35.6
United Kingdom *f*	51.7	12.6	35.7
Denmark *f*	48.6	10.3	41.1
Australia	48.8	9.7	41.5
Norway *f*	53.5	3.0	43.5
Belgium	52.8	1.5	45.7
Italy	49.3	3.0	47.7
France	45.2	5.1	49.7

a Details may not add to 100 percent because of rounding.
b Includes personal and corporate income taxes and compulsory contributions by employers and employees for social insurance and similar programs.
c Includes property taxes and estate, inheritance and gift taxes.
d Includes all taxes other than taxes on income and capital.
e Breakdown between taxes on income and taxes on capital not available.
f Fiscal year ending 1959.
Source: *Monthly Economic Letter* of the First National City Bank of New York, October, 1962.

Thus, as of 1960, Canada led thirteen other nations by a wide margin in the weight of the tax burden on capital.

And this without a capital gains tax and without consideration of the galloping growth of property taxation in the intervening years.

*Reproduced from "Tax Aspects of Canada's International Competitive Position", page 7: The Private Planning Association of Canada (1963).

LEGISLATIVE INEQUALITIES

Whether major new capital continues to be invested in Ontario, or in Canada as a whole, will depend upon the risks, as determined by the political, social and economic climate (of which taxation policy forms an important part) relative to the opportunities for profit presented the investor, whether he is domiciled in Canada or elsewhere.

IMMIGRANT ENTREPRENEURS

While the existence of transfer taxes does not have a pronounced effect upon capital flows within Canada, except in those situations contributing to the sell-out of Canadian privately-owned business,[1] instances exist of individual entrepreneurs turning from Canada as a country in which to establish domicile. The entrepreneurial talent which is thereby lost to Canadian enterprise must be accepted as unquestionably significant.

One instance involved a talented immigrant to Canada from his native Germany. Substantial investment in Ontario was involved over and above major investments in his native land, and this entrepreneur undertook to establish domicile in this province and take steps toward Canadian citizenship. Upon learning, however, that Canada's transfer tax legislation levies a tax on property, *wherever situate,* an immediate decision to return to Germany was dictated for not only himself but for his family partners in his homeland on purely economic grounds. The fact that Germany's transfer taxes are levied at the lowest rates of all countries examined in this report would have effectively raised the high marginal rates levied by Canada and Ontario to a level which would have compelled the sale of control of one of the world's major businesses. Since neither Canada nor Ontario reduce their estate tax or succession duty under any tax treaty or other reciprocal arrangement with Germany[2] and since Germany has recognized the importance to its domestic privately-controlled industry of not levying burdensome transfer taxes, avoidance of Ontario domicile can be readily understood.

Nor can this case be considered isolated. Canada's Estate Tax conventions are extended to but a handful of countries (United States, United Kingdom, Ireland, France, and South Africa), while Ontario reduces its duties to very few others (i.e. Australia, New Zealand, and the applicable states of the United States and to the District of Columbia).[3]

As was pointed out in the 1956 report of the Royal Commission on Canada's Economic Prospects, the characteristics of the Canadian system of income taxation (i.e. the 20% dividend tax credit, the Section 105 option to pay tax at 15% on undistributed surplus, the exemption of capital gains on equities, the relief afforded investment trusts, and the inter-company dividend exemption) "are all calculated to encourage investment in equities and in certain respects they constitute stronger incentives in that direction than do comparable provisions in the laws of the United Kingdom and the United States. There are, however, a number of factors which exert considerable pressure in the opposite direction. These, including our succession duty system, tend positively to discourage ownership of companies by Canadians . . .
". . . Concern as to the amount of succession duties and fear of inability to obtain these funds, particularly if the business continues to grow, has been one of the major factors in the transfer of ownership of many Canadian private businesses to foreign control. A large number of foreign businesses have located in Canada since the end of World War II: . . .[4]

(The Canadian federal government entered the transfer tax field in 1941, after which the tax bill of the average estate was considerably higher than

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[1] See page 22.

[2] See Appendix III, International Tax Treaties.

[3] Commerce Clearing House, *Canadian Estate Tax and Gift Reports,* page 2001.

[4] Glassco, J. Grant, F.C.A. *Certain Aspects of Taxation Relating to Investment Canada by Non-residents* — Report of the Royal Commission on Canada's Economic Prospects, Queen's Printer, Ottawa, 1956. P. 42 et seq.

it had been prior to that date.

"In many cases these companies have purchased an established Canadian business to act as a nucleus for their activities and succession duties have frequently been the Canadian owners reason for selling."[1]

Thus, not only does our transfer tax legislation induce disposal of domestic enterprise to foreign-controlled industry, but also it induces the foreign entrepreneur to retain his foreign domicile, rather than becoming resident in Canada.

COMMUNITY PROPERTY AND LEGISLATIVE EXEMPTIONS

Does 'Separatism' pay—and whom? is a question with a lengthy background in the field of transfer taxation. The United States federal government has modified its tax system to provide similar exemption to that available under Quebec's community property status to avoid the damaging effects of suddenly taxing away more liquid resources than most estates can produce if they are still to function productively.

"As a result of the specific provisions of the United States law and the operation of the community property law in Quebec where the parties have not contracted to be separate as to property, the duty payable on the death of the first spouse is greatly reduced . . .[2]

". . . The real significance of the American system and the Quebec system of community property is that, by deferring part of the succession duty problem until the passing of the second spouse, it is much easier for a man to make proper provision for his wife, which is frequently his chief concern, without his estate having to face immediately the full impact of succession duties.[1]

". . . On the other hand, . . . the absence in Canada of a marital deduction in cases other than those where the Quebec community property status exists, results in a situation where the amount of succession duty which has to be raised presents a very formidable problem. If the estate is \$5,000,000, approximately 50% will be payable in succession duties and if the estate is \$1,000,000 the duty will be about one-third or more. Since many individuals who have founded a business have a large part of their assets invested in the business, it may well become necessary to sell the business in order to pay succession duties. Under the United States system, or where community of property exists in Quebec, this sort of development is more often avoided."[1]

A graphic comparison of the exemptions afforded in Ontario—and Ontario and Canada combined —as against those provided in Quebec, Alberta (where the province now rebates its share of estate duties) and certain states of the United States is shown in chart VI. The inequalities need no comment.

These inequalities may be further exemplified by comparing the estate taxes and succession duties levied within the same jurisdictions on a \$200,000 net estate passing outright to the deceased's wife. Such a comparison is provided by Chart VII.

[1] See previous reference (J. Grant Glassco).

[2] See previous reference (Butler and Dickerson).

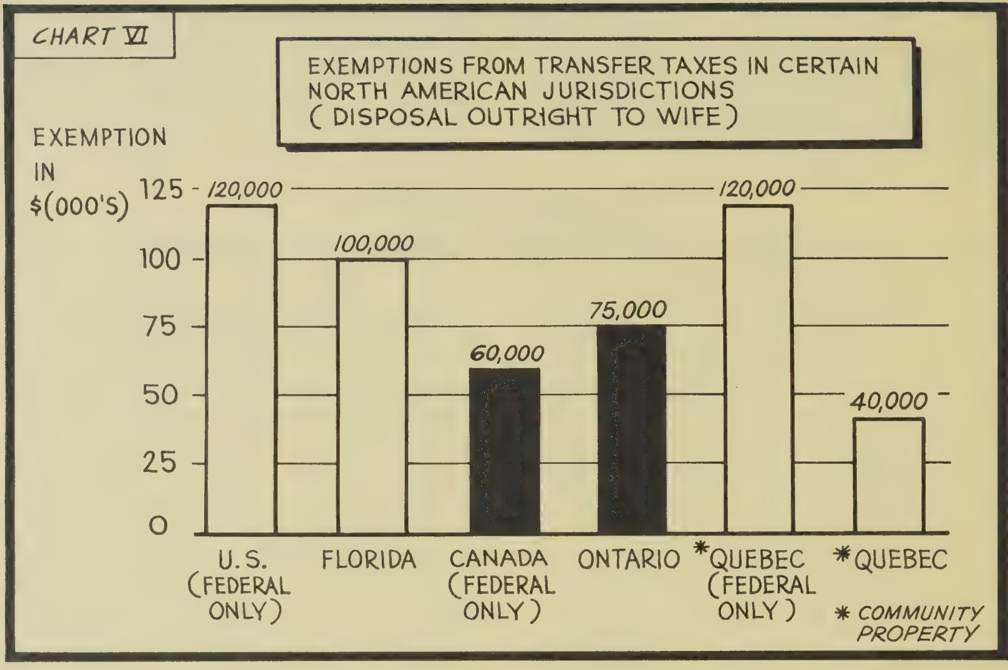


CHART VI
EXEMPTIONS FROM TRANSFER TAXES IN CERTAIN NORTH AMERICAN JURISDICTIONS (DISPOSAL OUTRIGHT TO WIFE)
EXEMPTION IN $(000'S)
125
100
75
50
25
0
120,000
100,000
60,000
75,000
120,000
40,000
U.S. (FEDERAL ONLY)
FLORIDA
CANADA (FEDERAL ONLY)
ONTARIO
*QUEBEC (FEDERAL ONLY)
*QUEBEC
* COMMUNITY PROPERTY

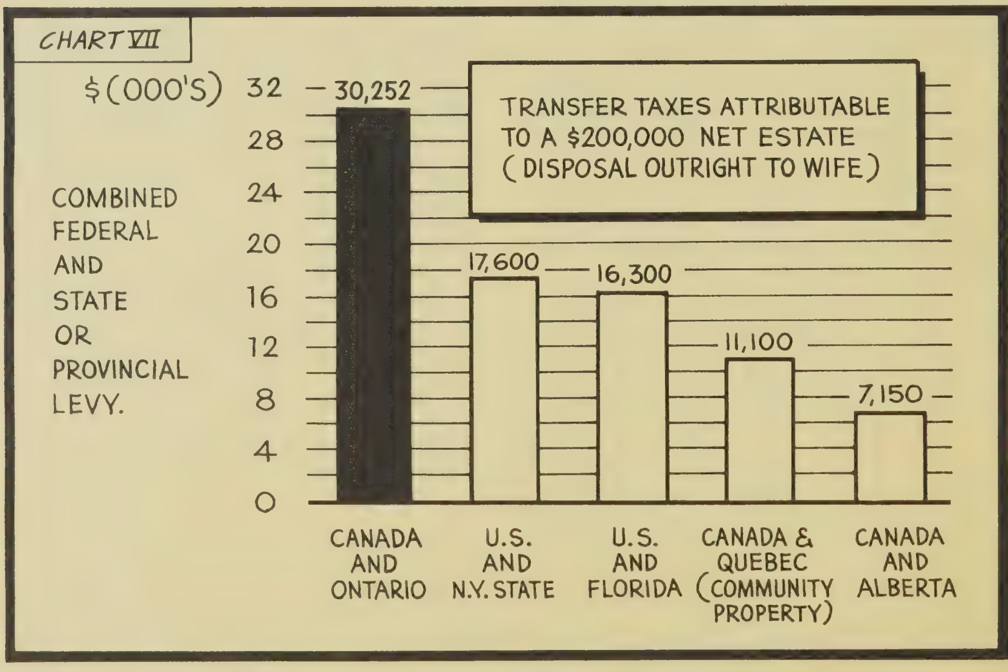
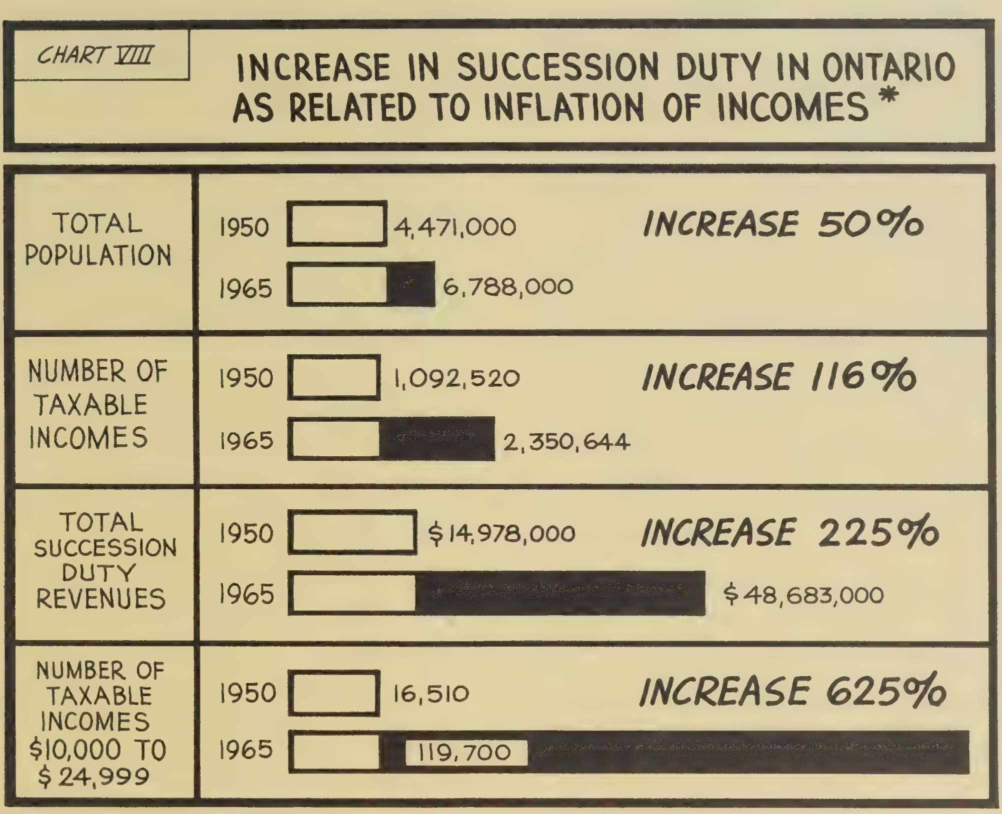


CHART VII
TRANSFER TAXES ATTRIBUTABLE TO A $200,000 NET ESTATE (DISPOSAL OUTRIGHT TO WIFE)
$(000'S)
32
28
24
20
16
12
8
4
0
COMBINED FEDERAL AND STATE OR PROVINCIAL LEVY.
30,252
17,600
16,300
11,100
7,150
CANADA AND ONTARIO
U.S. AND N.Y. STATE
U.S. AND FLORIDA
CANADA & QUEBEC (COMMUNITY PROPERTY)
CANADA AND ALBERTA

A PROGRESSIVE TAX STRUCTURE PLUS INFLATION
— THE TAX-COLLECTOR'S DREAM —



A fixed rate tax takes a constant per cent of the sum taxed, regardless of the size of that sum.

A progressive tax takes an increasing share of the sum taxed as the latter increases. Thus, as productivity and inflation enlarge the income of the taxpayer, the progressive income tax bites deeper.

The federal estate tax and the Ontario succession duty tax are also progressive taxes and a recent study[1] has demonstrated that there is a rough but distinct relationship between the level of income and the size of the estate at death of a magnitude of about one to 15.

In the 15 year interval reflected in the chart, Ontario's population has grown one-half but the number of taxable incomes has more than doubled, the revenue from succession duty taxation has trebled and the number of taxable incomes from $10,000 to $24,999 has grown more than six times.

From this data it is possible to foresee the trend of succession duty collections in Ontario under present legislation.

Using the rough ratio of one to 15 quoted above as one to 10 at $10,000 and one to 20 at $25,000, it would appear likely that such incomes would

* Data from "Taxation Statistics", Department of National Revenue, the Queen's Printer, Ottawa.

1 Cheng, Grant and Ploeger, "Ontario Estates in 1963-64", study for the Ontario Committee on Taxation.

provide a rapidly increasing number of estates in the range of $100,000 to $500,000.

This development is already evident in a breakdown of the 1963 Ontario Succession Duty revenues as analyzed by Cheng, Grant and Ploeger.[2] The total collections of $39 2/3 millions were derived as follows:

Taxable Estates		Range of Estate Size	Succession Duty Payments
No.	% of Total		
3,116	78.	Under $100,000	$ 9 millions
789	20.	$100,000 to $499,999	15 millions
51	1.3	$500,000 to $999,999	5 millions
27	0.7	$1,000,000 and up	10 millions
3,983	100.0		

[2] Previously cited.

The twin forces of productivity and inflation are rapidly enlarging both the first and second groups of taxpayers as a major source of succession duty income in Ontario. Even back in the 1963 year studied, 98% of taxable estates were in these first two ranges, and they were responsible for 60% of total provincial succession duty revenue.

This pronounced trend provides further evidence that succession duty taxation has drifted away from its original concept of preventing "undue accumulation of wealth". Instead, it taxes bequests from successful farmers, professional men, small businessmen and civil servants to achieve a rather unimportant addition to provincial revenues.

DUPLICATION OF TAXING BODIES

It would seem almost unnecessary to repeat the familiar axiom that any social control administered locally is inevitably superior to the same control administered from a distance. When the same field is administered both at home and from a distance, the only outcome to be expected is the costly and rancorous confusion which we experience.

> "As a statute of the federal parliament, the Estate Tax Act necessarily operates within the general law, most of which, constitutionally, is under provincial jurisdiction. Thus, while the Act will be interpreted in a way that will lay the tax burden equally on the citizens of all provinces, it is possible that different conveyancing and property rules may result in different tax liabilities from one province to another. The system of community property which prevails in Quebec is recognized in that the share of a deceased's spouse in such property is stated not to be property of which the deceased is competent to dispose. Further, an inter vivos gift made out of community of property is deemed to be made by each spouse according to their respective interests in the community property."*

Considering then

a. the desirability of administration of transfer tax legislation structured to the economic goals of the province.
b. the original permissive legislation
c. the confusion of legal authorities as well as those taxed, resulting from conflicting federal and provincial legislation
d. the miniscule yields in proportion to total income requirements
e. the damaging effect upon much-needed private investment

It is therefore recommended:

Recommendation 1

That the federal government be encouraged to review and simplify estate and gift taxation legislation for uniform operation by the provinces as a condition for its own withdrawal from the fields of estate and gift taxation.[0]

* Butler, M. E., and Dickerson, R. W. V., *Estate and Gift Taxation,* Wheatcroft, London, 1965.

[0] See also page 48.

COMPARATIVE EXEMPTIONS

Under Austrian transfer tax legislation an estate interest representing 10% or more of the net worth of a corporation is exempted from the annual death duty assessment on corporate net worth.*

Great Britain has similarly recognized, but to a lesser degree, the importance of alleviating the liquidity demands upon an estate comprised of land and buildings used for industrial purposes as well as industrial machinery and equipment and agricultural property.

No such alleviation is available under Canada's federal or provincial transfer tax legislation.

Other special exemptions prevailing in certain of the European nations, some of which appear to have application in Canada, and, more particularly, in Ontario, are as follows:

(1) Germany exempts art objects by German nationals who are either alive or deceased not more than 15 years as of the date of transfer. Within certain limits other art objects and collections, and property of public interest, are also exempt.

(2) France exempts three-quarters of the value of woods and forests on the condition that "normal" exploitation will be continued for a period of thirty years.
A recommendation of similar intent has been included within this report for adoption within a revised Succession Duty Act.

(3) Italy, Sweden and the United States federal government each exempt up to one-half the value of an estate when it passes to a surviving spouse. In addition, Sweden exempts all employment-derived pensions as well as certain life insurance and pension policies.

(4) France exempts new dwellings completed since January 1, 1948.

* See page 89, Section 3.

SALES OF CANADIAN COMPANIES TO FOREIGN OWNERSHIP

J. Grant Glassco,[1] commented on certain characteristics of the Canadian system of income taxation, such as the 20% dividend tax credit, the Section 105 option to pay tax at 15% on undistributed surplus, the exemption of capital gains on equities, the relief afforded investment trusts and the intercompany dividend exemption, as follows —"are all calculated to encourage investment in equities and in certain respects they constitute stronger incentives in that direction than do comparable provisions in the laws of the United Kingdom and the United States. There are, however, a number of factors which exert considerable pressure in the opposite direction. These, including our succession duty system, tend positively to discourage ownership of companies by Canadians . . .

". . . Concern as to the amount of succession duties and fear of inability to obtain these funds, particularly if the business continues to grow, has been one of the major factors in the transfer of ownership of many Canadian private businesses to foreign control. A large number of foreign businesses have located in Canada since the end of World War II."

In connection with the entry of the Canadian federal government into the transfer tax field in 1941, after which the tax liability of the average estate was considerably increased, Mr. Glassco commented . . . "in many cases these companies have purchased an established Canadian business to act as a nucleus for their activities and succession duties have frequently been the Canadian owners' reason for selling."

The question might well be asked, is it mere coincidence that the Canadian federal goverment's entry into the transfer tax field in 1941 coincides with the beginning of the post-war phenomenon of the take-over of Canadian privately-controlled business by foreign investors?

On the following two pages is reproduced from the public press a list of Canadian companies sold to foreign interest in the years 1964, 1965 and 1966.

Omitting those not located in Ontario and insurance companies and businesses already corporately controlled or with widely-distributed stock ownership, the list was reduced to 28 names. The previous owner or a top executive or executor of each was approached and asked to describe in confidence the circumstances which brought about the decision to sell.

Six of the 28 did not reply.

Of the 22 replies

—six said that transfer taxation was not a factor, or was of minor importance.

—sixteen advised that transfer taxation was the principal factor in ten cases and an important influence in six. This count rose to 18 when two principals pointed out that their companies were sold twice within a short period of years because of the impact of transfer taxation.

Thereafter follow key comments from these replies, without identifying the sources.

[1] J. Grant Glassco, Report of the Royal Commission on Canada's Economic Prospects (the Queen's Printer, Ottawa, 1956).

MAJOR SALES OF CANADIAN COMPANIES TO FOREIGN INTERESTS*

Company Acquired	Buyer of Control	Buyer's Headquarters
YEAR 1964		
John Labatt Ltd., London, Ont.	Jos. Schlitz Brewing Co.	Milwaukee, Wis.
Cdn. Collieries Resources Ltd., Vancouver	U.S. Plywood Corp.	New York
Building Products Ltd., Montreal	Standard Oil Co. (N.J.)	New York
Alberta Distillers Ltd., Calgary	National Distillers & Chemical Corp.	New York
Greening Industries Ltd., Hamilton	August-Thyssen Huette	West Germany
Banff Oil Ltd., Calgary	Societe Nationale des Petroles d'Acquitaine	Paris
Capital Wire Cloth Ltd., Ottawa	Appleton Wire Works	Appleton, Wis.
Imperial Flo-Glaze Paints, Ltd., Toronto	E. I. du Pont de Nemours & Co.	Wilmington, Del.
Ernest G. Robinson Ltd., Toronto	Pet Milk Corp.	St. Louis
Boese Foods Ltd., St. Catharines	California Packing Corp.	San Francisco
J. A. Johnston Co., Brockville	Genesco Inc.	New York
McGregor Sportswear of Canada Ltd., Guelph	McGregor-Doniger Inc.	New York
Guelph Stove Co., Guelph	Studebaker Corp.	South Bend, Ind.
Walker Metal Products Ltd., Windsor, Ont.	Chrysler Corp.	Detroit
A. J. Sales Co., Ridgetown, Ont.	Kysor Industrial Corp.	Cadillac, Mich.
Chatham Plating Ltd., Chatham	Kysor Industrial Corp.	Cadillac, Mich.
Columbia Forest Products Ltd., Sprague, Man.	U.S. Plywood Corp.	New York
Plate & Structural Steel, Toronto	Sterling Precision Corp.	New York
Montreal Casein Co., Montreal	Foremost Dairies Inc.	San Francisco
Kralinator Filters Ltd., Preston, Ont.	Sheller Manufacturing Corp.	Detroit
Bradley Finance Co., London, Ont.	United Dominions Trust Ltd.	London
A. H. Marston Corp., Toronto	Church & Co.	Northampton, England
Barrday Ltd., Galt	Wheelabrator Corp.	Mishawaka, Ind.
Upper Canada Insurance Co., Toronto	Boston Insurance Co.	Boston
Universal Insurance Agencies Ltd., Toronto	Boston Insurance Co.	Boston
Acadia Cordage Ltd., Nova Scotia	W. R. Grace and Co.	New York
Ashton Manufacturing Co. Ltd., Ottawa	Bristol Aeroplane Co. Ltd.	Britain
Young Spring & Wire Corp. of Canada Ltd., Windsor	Chrysler Corp.	Detroit
Cogan Wire and Metal Products Ltd., Montreal	Charterhouse Group Canada Ltd.	Britain
Griswold Corp. (1961) Ltd., Montreal	International Paper Co.	New York
YEAR 1965		
Telephone utility of Brazilian Traction, Light & Power Co. Ltd., Toronto	Brazilian Government	
Clark Foods Ltd., Montreal	Green Giant Co.	Le Sueur, Minn.
Fleetwood Corp., Montreal	RKO Distributing Corp. of Canada Ltd.	Toronto
Holt Renfrew & Co. Ltd.	Canadian Acceptance Corp. Ltd.	Toronto
Charles E. Frosst & Co., Montreal	Merck & Co. Inc.	Rahway, N.J.
Westburne Oil Development Ltd., Montreal	Great Plains Development Co. of Canada Ltd.	Calgary
Onward Manufacturing Co. Ltd., Kitchener	National Union Electric Corp.	Stamford, Conn.
Hahn Brass Ltd., New Hamburg, Ont.	Amerock Ltd.	Meaford
Switson Industries Ltd., Welland	General Signal Corp.	Rochester, N.Y.
Texpack Ltd., Brantford	American Hospital Supply Corp.	Evanston, Ill.

Company Acquired	Buyer of Control	Buyer's Headquarters
New York Wire Works Ltd., Montreal	Charterhouse Group Canada Ltd.	Toronto
Canadian Coachways Ltd., Edmonton	International Utilities Corp.	Toronto
S. M. Simpson Ltd., Kelowna, B.C.	Crown Zellerbach Canada Ltd.	Vancouver
Seeley Systems Ltd., Toronto	Acme Visible Records Inc.	Crozet, Va.
Propas Chemicals & Equipment Ltd., Sarnia	Pfizer Co. Ltd.	Montreal
Becker Drilling (Alberta) Ltd., Calgary	Union Carbide Canada Ltd.	Toronto
Wellington-Walker Ltd., Prescott, Ont.	Warner Bros. Co.	Bridgeport, Conn.
London Pure Milk Co. Ltd., London, Ont.	Borden Co. Ltd.	Toronto
Tilley's Ltd., Toronto	Kiwi Polish Co. (Canada) Ltd.	Hamilton

YEAR 1966

Quebec-Telephone, Rimouski, Que.	Anglo-Canadian Telephone Co.	Montreal
Okanagan Telephone Co., Vancouver	British Columbia Telephone Co.	Vancouver
Brinton Carpets Ltd., Peterborough	Armstrong Cork Canada Ltd.	Montreal
Bick's of Canada Ltd., Toronto	Robin Hood Flour Mills Ltd.	Montreal
General Paint Corp. of Canada Ltd., Vancouver	Canadian Wallpaper Manufacturers Ltd.	Toronto
Dominion Tack & Nail Co. Ltd., Galt	Plymouth Cordage Co. of Canada Ltd.	Welland
Jackson Metal Industries Ltd., Hamilton	Acme Visible Records Inc.	Crozet, Va.
Canada Last Co. Ltd., Preston	Vulcan Corp.	Cincinnati
Tillsonburg Machine Ltd., Tillsonburg	Hoover Ball & Bearing Co.	Ann Arbor, Mich.
Air Coils Manufacturing Co. Ltd., Oakville	Worthington Air Conditioning Co.	East Orange, N.J.
Broadway Knitting Mills Ltd., Montreal	Koret of California Inc.	San Francisco
Canadian Special Machinery Ltd., Port Credit	NRM Corp.	Akron, O.
Conroy Manufacturing Co. Ltd., Oakville	Kelsey Wheel Co. Ltd.	Windsor
W. Freeman & Son Ltd., Burnaby, B.C.	Sylvania Electric (Canada) Ltd.	Montreal
General Wire & Cable Co. Ltd., Cobourg	Seilon Inc.	Toledo, O.
Mercury Tool & Stamping Ltd., Toronto	Tonka Corp.	Mound, Minn.
Nasco Products Ltd., Hamilton	Hayes-Dana Ltd.	Thorold
Parkinson Inks Ltd., London, Ont.	Interchem Canada Ltd.	Toronto
Pick Timber Co. Ltd., Sault Ste. Marie, Ont.	Calumet & Hecla Inc.	Evanston, Ill.
McDonald Welding Ltd., Oakville	Wheelabrator Corp. of Canada Ltd.	Toronto
Toronto Macaroni & Imported Foods Ltd., Toronto	General Mills Inc.	Toronto
Turnbull Elevator of Canada Ltd., Toronto	Dover Corp.	New York
Turnbull Elevator Inc., N.Y.	Dover Corp.	New York

*Reprinted from the Globe and Mail (Toronto) Jan. 8, 1965 — Jan. 5, 1966 — Jan. 3, 1967.

EXCERPTS FROM THE LETTERS OF PRINCIPALS

commenting upon transfer taxation as a factor in the sale of their businesses

"Our growth accelerated from about 19__ and shortly afterwards we began to appraise the effect of succession duties on the principal shareholders and on the Company. We held discussions with our lawyers, our auditors, the president of a chartered bank and some business friends who had faced up to the same problem. From information obtained in these discussions, it was obvious that, in the event of a death of any one of the principal shareholders, it would create an extremely serious problem, for the valuation that would be placed upon our shares, based upon the earning record, would be so high that the Company would have to be sold for the estate to pay the succession duties.

"We talked with several underwriters, and they all advised that our Company was too small at that time for a public issue."

* * * * * *

"My father and grandfather died in 19__ and 19__ and we then realized how serious and disastrous Succession duties could be. We also realized that if anything happened to ________ or myself the business would have to be sold to pay taxes. Therefore, ... we re-organized and changed the name . . . . . changed our financial set-up . . . . . ; but by 19__ we further realized that we didn't have sufficient cash for Succession duties and we were forced to sell control of our Company . . . . . it was very successful; so much so that the people who bought control realized in 1965 that in order for them to pay their Succession duties it would have to be sold."

* * * * * *

"A little over three years ago we sold controlling interest in our company which was owned by my partner and myself to a wholly owned subsidiary of an American company. In essence, I would say that 65% of the reason we came to this decision was due to the very critical position we found ourselves in with regards to estate tax and succession duty due to the rapid growth in our company since its incorporation in 19__.

"There were other reasons of course, for this decision but they were primarily of a personal nature."

* * * * * *

" . . . some of the causative factors that contributed to my decision to dispose of my former business were the following:—

1. Ill health.
2. The business required a major capital expenditure to move it into its next phase of growth. If it were to continue in the former pattern it would have deteriorated, and the opportunity to sell at a later date would have been diminished.
3. To crystallize my estate tax and succession duty imposition. In case something were to happen to me at the time, my business would have been valued at a much larger valuation than the net value by income tax people, and the imposition of estate taxes and succession duties could have cleaned out any surplus that I had built up over a period of 20 years."

* * * * * *

"While there were several minor considerations in our decision to sell to American interests, by far the most predominant reason was the fact that the business would have had to have been sold to meet estate taxes and succession duties at some future date. While we worked for intermediate solutions, none was practical, and the family therefore decided that we had no alternative but to sell completely to American interests who had a close association with us in our product line."

* * * * * *

"To sum up, the one and only reason we sold was the Estate Tax problem. We had weathered it once in 19__, but with the great growth since then, plus the hopes we had for the future, we simply saw no satisfactory way to surmount the problem a second time.

"Within the past two weeks, __________ died suddenly, and it would therefore appear that our concern in 1964 was warranted."

"My only reason for selling was the potential impact of Succession Duties. I worked hard to build this business for my sons, but present Succession Duties made this impossible. The only way I could protect my family was by selling the business. About everything I had was invested in this business.

"Upon death, the business would have to be sold to pay Succession Duties and no doubt, it would have to be sold at a bargain price . . .

"At present, it is rather foolish to start and develop a business. With Succession Duties the way they are, it is not worth the risk and hard work."

* * * * * *

"2. In order to expand again and to be competitive with __________ and my other competitors, I would have to borrow a large sum from the Industrial Development Bank on a short term program and hope that I had enough capital and financing from the bank to put in a large inventory and be able to carry the receivables for at least 90 days, which were the terms my competitors were soliciting.

"3. In the event of my death, my wife and family would have to sell the company to pay my Estate Tax and Succession Duty and thus be at the mercy of the wolves. Therefore, I feel the Tax and Duty aspect was the main reason for selling."

* * * * * *

"Succession Duty was the prime reason why the company was sold; however, the fact that we were able to get a good price quickly from readily available American interests caused the sale to be effected much earlier than it otherwise would have been economically possible."

* * * * * *

"Firstly, we found that in order to expand and continue our rate of growth, required large additions of capital, and building up a coast-to-coast marketing program entailed many offices, warehousing, etc.

"Secondly, the three principal shareholders are not young, and the problem of Estate Tax and Succession Duties just had to be faced squarely. This was reflected in our planning, thinking, and in our capital and bank borrowing. We felt that we could not perform fairly in the interests of our families, the shareholders and employees."

* * * * * *

"With the coming of Free Trade in Automotive we felt it was a good time to set up our estate so estate taxes wouldn't be such a burden. The estimate of plant or share value could prove a disaster to our estate as a great deal of our holdings were in the plant. To cope with Free Trade and the U.S. market it also meant huge amounts of money would be needed for enlargement of premises; since selling this has come about."

* * * * * *

"While we had a great desire to continue to go it alone the officers of the Company, all shareholders, were of the same opinion with regard to their long term shareholding in relation to succession duties and we were also concerned about the position of small manufacturing companies in relation to the present economic and labour conditions in this area."

* * * * * *

"When sold in 19__, the company was encountering strained financial conditions. These conditions were aggravated by pressure from family shareholders dependent upon the company for personal dividend income. A major concern (estimated by Mr. __________ to be a 70% factor in the family pressure to sell) was also the succession duties which would be attributable to the share interests owned by these family shareholders. Since these shareholders estates were illiquid, realization of funds to meet the cash demands of succession duties would have involved a forced sale of shares held. As 80% of the issued shares were family-ewned, the balance being held publicly, any forced sale of shares to meet succession duty obligations would have depressed the "thin" market available.

"Ironically, the company which purchased ___ _______ Limited, was, itself, subsequently sold to provide cash to its major shareholders to meet their succession taxes."

* * * * * *

"We too have had exceptional growth since 19__ and we do have a greater potential in the future. There will definitely be a succession duty problem in continuing the solvency of our firm when it must pass into the hands of the next generation of the ___________ family."

"___________ Limited was not a large enough company to become a public company.

"Thus, Mr. ________ came to the conclusion that it might be wise to sell the business so that he could enjoy now the capital appreciation arising from inflation and lead an easier life with much fewer responsibilities and work. If he attempted to keep up with the rising costs of inflation and income tax, it would only mean that he would have an increasing amount of money tied up in a business and thus materially increase the succession duties and estate taxes which would be payable by his estate."

IMPACT OF TRANSFER TAXATION UPON INVESTMENT

in shares of Canadian private companies

R. R. Romberg, in his paper[1] for the Economic Council of Canada, stated: ". . . The increase in the labour force expected over the period to 1970 is more rapid than that of any other industrial country. In order to provide employment for the additional labour force, a rapidly rising level of economic activity will have to be achieved over a prolonged period. This requirement entails, in turn, a sharp increase in domestic investment. In view of the high import content of investment, these developments must be expected to result in some tendency toward widening of the deficit on current account in the balance of payments. This tendency can be countered only by policies which induce a strong export (and import-replacement) performance or a large private capital inflow into Canada, or a combination of both."

Dr. A. K. Eaton commented:[2] "Funds "ploughed back" for growth do not meet the high personal (income tax) rate structure. High personal rates do mean, however, that more profits have to be distributed in order to leave the chief shareholder enough to live on. Accordingly, they cut into the supply of capital otherwise available for investment."

It might well have been added that still more profits have to be distributed to the chief shareholder in order, not only to leave him enough to live on, but also enough to enable his estate and successors to pay death taxes. Accordingly, the supply of capital otherwise available for investment is further curtailed.

As a practical illustration of the impact of transfer taxation upon private business, a hypothetical example is presented.

X is a working stockholder in a private company. X owns 20,000 shares in the company, which is 25% of the issued stock. Over a period of 10 years the company has a net annual average income before taxes of $5 per share, which under present law results in the following annual distribution:

(A) *Division of the annual earnings of X's stock*			*Disposal of the annual earnings of X's stock*		
			$ Retained by Company	**To X**	**$ Paid to Government**
Income before tax = 20,000 x $5	=	$100,000			
Corporation Income Tax*		52,000			52,000
Net income after tax	=	48,000			
Paid in dividends to X	=	24,000			
Retained in company surplus		$ 24,000	24,000		
X's dividend income	=	24,000			
Less income tax**	=	11,245			11,245)
		$ 12,755			
Add 20% dividend credit	=	4,800			−4,800)
X's net dividend return	=	17,555		17,555	
			$ 24,000	17,555	58,445

Note: 1 Rudolph R. Romberg, Effects of Exchange Depreciation in Canada, September 1, 1965.
2 Dr. A. K. Eaton, "Essays in Taxation" (Canadian Tax Foundation, 1966).

* A flat rate of corporate tax has been adopted in preference to the more complex (and actual) rates of 23% on the first $35,000 of corporate income and 52% on the excess over $35,000.

** X's income (other than his dividends here discussed) was $15,300. The $24,000 of company dividends created an additional gross tax liability of $11,245 against which he received a dividend tax credit of $4,800.

(B) Thus, over a period of ten years X's stock has earned $1,000,000 gross, which is divided as follows:

To government	$ 584,450 =	58.4%
To X	175,550 =	17.6%
To company surplus	240,000 =	24.0%
	$1,000,000 =	100.0%

X dies at the beginning of the eleventh year, leaving his estate to his widow. The 20,000 shares of stock valued by government auditors at $24 per share (ten times annual net earnings) is the net taxable estate. Estate and succession duties would be $118,102. There are three possible solutions at this point:

1. Keep the stock and pay the tax due.
2. Sell X's stock to pay the tax.
3. Sell control of the company to pay the tax.

(C) Solution 1

If funds were available from the wife's assets and it was deemed worthwhile to keep the stock, payment of the tax would result in the following net distribution of the proceeds of ten year's income in X's stock.

To government	$ 702,552 =	70.3%
To X and his estate	57,448 =	4.7%
To company surplus	240,000 =	24.0%
	$1,000,000 =	100.0%

In the U.K. or the U.S. up to as much as 10 years is allowed to pay the tax on such an estate, but in Canada it is payable within six months of the deceased's death. In any case, it is obvious that unless the company's earnings were greatly enlarged it would take almost all the net earnings of the next ten years to pay the tax due and the interest charges. So in Canada, this solution is totally unlikely.

(D) Solution 2

A sale of X's shares is made for $24 per share or $480,000 cash. This is indeed fortunate for now the distribution of the $1,480,000 which has accrued to X's investment is as follows:

To government	$ 702,552 =	47.4%
To X and his estate	537,448 =	36.4%
To company surplus	240,000 =	16.2%
	$1,480,000 =	100.0%

But this solution also is purely in the dream world, for no individual investor (Canadian or foreign) would invest such a sum in a minority holding in order to place himself in the same liability situation as X.

(E) Solution 3

All (or more than half) of the shares of the company are sold to a corporate buyer (the usual solution).

The 10-year distribution of the proceeds of X's investment is the same as last shown in Solution 2, above.

If the new ownership is foreign, the dividends paid now *flow out of Canada.*

(The reader, of course, will be aware that we have not reported the total impact of taxation upon X's investment, for it will also have been paying its municipal taxes during the 10-year period reviewed.)

If X's business shows promise, it is obvious that the new owner must provide more capital in order that it can grow and provide more employment. For as a result of income and estate taxation, only $240,000 remains in the business out of the $1,480,000 already attracted by X's investment.

Because this particular impact upon small Canadian (particularly Ontario) private companies is well known, most major proprietors of such businesses take offsetting steps in advance. Unfortunately, the most common of these steps is to sell the business, and all too frequently, because there are so many advantages on their side, the buyers are larger foreign firms.

The following recommendation is therefore offered:

Recommendation No. 2

That where more than ten percent of the issued and paid-up capital of a private Canadian corporation possessing assets of which not more than ten percent are securities of public corporations or government is represented by shares owned by a deceased at the time of his death, the value of such shares be included in determining the rate of transfer tax to be applied to other estate assets, but such value be exempted from transfer tax unless such shares are sold within a period of ten years.

Reference may be made to Austrian death tax legislation as a precedent. See Appendix III, page A64.

SECTION 2

AN ANALYSIS OF TRANSFER TAXES:

THEIR SOCIAL AND ECONOMIC DERIVATION AND CONSEQUENCES

by J. K. Savage

Though the percentage of revenue from transfer taxes received by Canadian governments is exceeded among the nations of the Western world only by the governments of the United States and the United Kingdom, the relative maturity of the economies of these two prominent countries, when compared to that of Canada, raises a question as to the merit of thus dissipating and discouraging private accumulations of investment capital.

The answer may well be that most Canadians are unaware that transfer taxes are, in fact, taxes levied upon investment capital . . . and that Canada ranks above all other nations in the share of taxes raised from taxation of all forms of capital investment.*

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* See "Taxation of Capital in Fourteen Nations". Page 15.

SOCIOLOGICAL CONSIDERATION OF TRANSFER TAXES

The foundations of all economies rest upon sociological grounds, for it is the collective pressures and aspirations that provide the basis for successful incentives, individual and collective enterprise, and governments and their taxation systems.

Without socially sanctioned expectations of standard behaviour to provide a blueprint for individual goals, co-operative adherence to a pattern of conformity, as we know it today, would be absent. There could not exist a taxation system based upon voluntary compliance, nor could there exist the productive economic society of which each of us is a cooperative contributor and/or benefactor.

The creation of wealth, controlled by individuals, has, at least in North American society, a traditional-religious basis. The Puritans and others who rejected the restraints of the class societies of their ancestral cultures for the opportunities offered by the classless North American culture sowed the seed for the development of the aggressive, yet conscientious society in which we live today.

Western capitalism, or organization of free labour into methodical, rational and disciplined productivity, rests in part upon the religious belief that productive endeavour is one of the prerequisites to "salvation". Wealth created as a result of labour is, in itself, representative of the degree of ethical success. Conversely, not to create wealth is a denial of one's duty to labour.

According to Max Weber, the importance of craftsmanship provided the ethical justification of present-day specialized division of labour. Similarly, the providence of wealth accumulation, resting as it does upon the duty to labour as measured by profits created, serves as the justification of the activities of the businessman. Religious honour, and thus, socially accepted behaviour, dictates against spendthrift consumption of accumulated wealth, therefore requiring re-investment.

It is against this background, and upon this historical foundation, that Western Capitalism has developed and continues to develop. But other incentives to labour have prevailed — the greatest of which has probably been that of fear of genuine want. Today, however, with abject poverty being substantially unknown in much of our North American society, and adherence to early religious dogma waning, these incentives have been replaced by the incentives of position and privilege.

On the basis of sociological considerations, therefore, at least in the present stage of development of our society, the existence of succession taxes as part of our taxation system cannot be considered to act as a disincentive toward productive labour by those who seek to create personal wealth.

"The virtual impossibility of accumulating capital, or of making large-scale provision of wealth for future generations, or even for the saver's own immediate future, without losing through taxation and inflation the greater part of the money saved, is naturally the most potent of the present forms of discouragement of effort based upon the desire for gain. The taxation factor, particularly the purchase-tax, is also of great importance, since heavy taxes have the effect of making goods which might otherwise be wanted and worked for seem not worth the effort involved to obtain them. . . .[1]

"Apart from the three fears, of punishment, of want, and of loss, and the hope of material gain and of social betterment, the most effective motive for effort, and one which has much bearing upon the attitude of the taxpayer to the community, is loyalty, or *esprit de corps*".[2]

While remaining unaware of the source of his motivation, or if aware, relegating it to the background, the incentive to attain, and retain, social respect provides much of the basis for man's acquisitive desire for wealth. Possessing wealth, he is able to portray the outward appearance seemingly necessary to command that respect.

In framing a taxation policy, therefore, considerable attention must be given to the mainte-

[1] Lady Rhys-Williams, D.B.E., *Taxation and Incentive,* Oxford University Press, New York, 1953, p. 22.
[2] Ibid. p. 24.

nance of an economic environment in which material gain, and, thus, social respect, may be achieved. Without men of wealth, commanding as they do this social respect, and the example that it provides, the incentives to others toward similar position through productive achievement would not exist. Whether death taxes serve to bring the attainment of wealth through self-achievement into clearer perspective by reducing the opportunity for an idle class of wealthy heirs to bequeath similar opportunities for idleness to their heirs, or whether they destroy the opportunity to continue productive private enterprise, depends upon the extent and method of application of such taxes. As presently applied in Canada, and more particularly in Ontario, Quebec, and British Columbia, the impatient cash demands of death tax legislation tend to discourage private enterprise from being continued by intended heirs, thereby serving to encourage less productive, if not idle, heirs to exist upon the inherited income from the proceeds derived from the sale of a private business.

Despite this fact, far too great an emphasis, we believe, has been placed upon the potential danger of proliferation of idleness arising from inherited wealth, even when invested in the form of public securities. Far more frequently, the heir is provided the opportunity to fulfill latent ambitions in business, science, or the arts, thereby benefitting society as a whole. Self-directed achievement remains, we believe, a far greater incentive than state supported and directed effort.

"It follows that the case for the redistribution of wealth upon purely moral grounds has to be qualified by the fact that the greatest good for the greatest number, even if admitted to be the principal objective of statesmanship, depends upon the husbanding of resources in some degree in order to produce the maximum amount of wealth. There can be no permanent gain to anyone through the mere scattering of existing wealth."[3]

The prospect of death taxes being imposed upon the wealth that one has been fortunate enough to accumulate, despite inflation and taxation, affects entrepreneurial drive very little. Industrial sociologists, such as March and Simon[4] have demonstrated considerable success in validating concepts of human motivation. These concepts are akin to the three fears of punishment, of want, and of loss. These and the hope of material gain, and of esteem referred to previously, shape individual needs.[5] Sociological research has demonstrated that positive incentives toward productive effort are related almost wholly to the individual's position in society, his relative achievement, and his sense of progress and accomplishment.

Not so the possession of wealth itself. Monetary incentives remain strong only so long as physiological needs are not adequately satisfied. Once material desires are reasonably satisfied, the emphasis upon wealth accumulation may change, but not necessarily to a significant degree.

The degree of change depends upon the individual's desire for prestige and power. He may possess this desire whether his wealth has been the product of his own achievements or has been inherited. "Andrew Carnegie and Charles Schwab have asserted that the motives behind the accumulation of their fortunes and those of most multi-millionaires is not any family sense, but the enjoyment of personal accomplishment and the 'playing of the game'. Certainly inheritance taxes would not place a damper on these items of accumulation."[6]

The major sociological product of the imposition of death taxes is the effect upon heirs to be engaged, or who would otherwise have been engaged, in continued control and administration of a private business. In those cases in which death taxes contribute to the disposition of such a business, whether such disposition is made in contemplation of death or as a means to raise cash to meet estate liabilities, the oft-resulting investment by heirs of their respective shares in public securities serves to encourage, rather than discourage, the segment of the citizenry dependent upon investment income.

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[3] Ibid. p. 44.

[4] March, James G., and Simon, Herbert A., *Organization*, New York, Wiley, 1958.

[5] See previous footnote[2], page 32.

[6] Schultz, Wm. J. Ph.D., *The Taxation of Inheritance*, Houghlin Mifflin Company, The Riverside Press, Cambridge, 1926, p. 205.

ECONOMIC CONSIDERATIONS OF TRANSFER TAXES AS APPLIED TO SOCIETY

The macro-economic effects of death taxation operate through the collective decisions of predecessors[1] in contemplation of death, and the attendant dispositions of their assets and the tax that such dispositions invoke, and upon the successors through their reactions to the prospect of their inheritance and the taxes attributable thereto.

From the point of view of the predecessor, death taxation may influence his decisions during his lifetime. In this class of economic effects are those that influence decisions to work or not to work, to spend for consumption or to save, and to acquire assets in one form rather than another.

In reference to the decision to work or not to work, death taxation will influence those strongly motivated to bequeathing wealth to continue to work and thus to increase further the bequests to be received by heirs. The desire to place increased wealth in the hands of their heirs is increased by death taxation. The concept of the utility of a dollar received after tax by heirs is increased owing to being required to save, say a dollar and a half before tax.

Similar motives can operate in the opposite direction: the marginal rate of death taxation attributable to a dollar saved can induce predecessors to give up or reduce work toward the accumulation of estate assets.

Operating in opposite directions, death tax — induced work or leisure provide an indeterminate conclusion. It appears extremely unlikely that productive effort of predecessors as a whole is affected quantitatively by the existence of death taxation.

Similarly, there exists conflicting evidence of increased as well as reduced consumption. Increased consumption arises from the desire to enlarge the propensity to consume or to "disinherit" undeserving heirs (whether the government or otherwise) by spending capital (i.e., dis-saving) during one's own lifetime. Reduced consumption arises from the desire to increase the inheritance to intended heirs by preserving and increasing capital. While no empirical data is available to support the degree to which these opposite tendencies prevail, considerable practical experience has confirmed the existence of these extremes. By inference, as the result of the position of the taxing authorities as unintended heirs, there appears to be a slightly greater tendency toward an increase in personal consumption (i.e., dis-saving) rather than toward a decrease in consumption (i.e., increased saving). Whether this pattern is solely a reflection of the existence of death taxation cannot be determined. To the degree that increased consumption exceeds increased savings, as a result of death taxation, then for the national economy as a whole capital investment within the private sector, at least, will be curtailed.

The inheritance tax, itself, will result in a reduced level of national capital investment, and thus contribute to this tendency toward dis-saving to the extent that the tax revenue is utilized to meet current government expenditure rather than capital expenditure.[2]

Asset composition within an estate provides the most important example of the effects of death taxation. The distribution of an estate among heirs provides the primary incentive to aged predecessors to arrange their assets in a form so as to be readily divisible. A secondary, but often more important incentive to liquefy an estate is centered upon the necessity to meet death tax liabilities in cash.

To the extent that death taxaton intensifies the liquidity problem, made severe enough through the operation of high marginal rates of income taxation propelled to higher levels through inflation, so too is the problem of an inadequate supply of enterpreneurial risk capital intensified.

The pressure of death taxation toward maintaining in each potential estate an adequate pool of liquid funds subtracts from the national pool of

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1 *predecessors* persons placing their affairs in order in contemplation of death.

2 Of course this tendency may be more than offset by government capital expenditure being financed out of other forms of taxes, primarily consumption-based taxes. On a federal level from capital expenditure must be subtracted the substantial sums destined for defence purposes as such expenditure does not contribute as productive capital.

capital at risk. Failure to maintain such funds contributes to the absorption of increasing numbers of private businesses by large corporations with the attendant displacement of private risk capital. Such pressure toward maintenance of liquidity detracts from an expending economy dependent upon the need for incentives to sustain adequate supplies of risk capital. Substitute reduced-risk marketable securities for the risk capital of private enterprise and the substitution is investment income for earned income. Substitute investment income for earned income and the substitution can be a reduced level of productivity.

The national economic effects of death taxation, at this stage of our nation's development, are reflected in a dissipation of estates through: a tendency toward increased consumption by predecessors, (e.g., a measurement of this is the lower retirement ages of businessmen who must thereafter live upon capital or investment income); absorption of private businesses into increasingly large corporate concentrations; and significantly increased economic importance of charitable organizations fostered by their tax-exempt receipt of gifts and bequests.

The national economic effects are potentially measurable in reduced productivity both from labour and from capital. Absorption of the private business by the corporate giant frequently assures the first; substitution of readily-marketable public securities for private capital can produce the second. Death taxation fails, therefore, in one extremely important aspect: it fails to provide incentive toward keeping private capital employed at the highest possible rate of return. A less productive allocation of resurces ensues.

Those responsible for guiding the course of our nation's development need only to look to history to find proof that nearly every past civilization has hastened its ruin through its dissipation of capital by taxation.

The current economic dilemma in Great Britain, for example, must be examined in the light of that statement. What is capital? Stated simply, capital must be considered to be tax-paid, unspent, invested earnings. To induce consumption through government welfare expenditure by levying steeply progressive rates of taxation on incomes barely sufficient to meet necessary costs of living, or directly through the expenditure of savings which would otherwise shrink due to inflation, must, therefore, be concluded to be consumption of capital through discouragement of incentives to save. Present economic policy within Canada must be similarly examined.

"Tax rates are below economic limits if they permit the development of a large, economically sterile leisure class; they are above the taxable limits if they interfere with the dynamics of the economy, if they interfere with the economic incentives of the working individual."[3]

ECONOMIC CONSIDERATIONS OF TRANSFER TAXATION AS APPLIED TO THE INDIVIDUAL

Modern tax systems adhere, in principle, if not in fact, to the socially accepted concept of "ability to pay", and, therefore, adhere reasonably closely to a progressive rate structure.[1]

Death taxation, as we know it in the social principles behind the Estate Tax Act (Canada) and the Succession Duty Act (Ontario), appears, on the surface, to adhere closely to this basic concept of ability to pay. Closer examination of the application of this concept in these Acts gives rise to the economic consideration of "Whose ability to pay?" Does death taxation, in fact, adhere to the concept of "ability to pay?" For it to do so, the net worth of the recipient of a bequest would be required to be considered. But while many proponents of an inheritance tax levied upon the recipient of a benefit from a decedent's[2] estate consider it to be fairer than an estate tax levied upon the decedent's estate itself, neither an inheritance tax nor an

[3] Imrie de Vegh, *Limits of Taxable Capacity,* Tax Institute Inc., 1953.
[1] The Income Tax being the best known progressive tax.
[2] decedent — i.e., the person bequeathing the estate.

estate tax adheres to the socially accepted concept of "ability to pay", for neither bases its rates upon the net worth of the recipient.

The concept of "ability to pay" would appear to be at odds with the generally accepted conclusion that the incidence[3] of a death tax falls upon the decedent. If the incidence of death taxation rests upon the decedent, then the recipients of bequests of the decedent's estate bear no burden whatsoever, other than a normally-short-lived bereavement, and surely are free from an economic burden of the tax. Since whatever is inherited constitutes an addition to the ability to consume, whatever is received should be received gratefully.

But has the burden of the death tax been shifted entirely to the decedent? It appears that it has, at least to the extent that the estate was created by the decedent's foregone consumption,[4] rather than through a reaping of the benefits of fortune, such as through a relatively fixed resource (e.g., land) gaining in value through increases in demand. Even in this case, however, it may be reasoned that the decedent has borne the incidence of the death tax by not spending his fortuitous gain. Might it be concluded, therefore, that since successors would receive increased ability to consume for which no effort on their parts had been expended, the benefit should be taxed away in its entirety?

Needless to say, taxation at one hundred percent rates is unacceptable to even the most socialistic individual, be he economist or politician. Further, there is much to substantiate the argument that the incidence of death taxation does not rest solely upon the decedent through his foregone consumption. There is also evidence to substantiate the claim that large estates, at least, are not created through the process of foregone consumption and the increased individual saving resulting.

To this argument, we will return later. Dealing first with those estates whose creation has without question been from foregone consumpion, we ask the question, "whose foregone consumption?" The decedent's? Surely, there must also be included in this class whose consumption has been reduced not only the decedent, but also those directly dependent upon him (i.e., primarily his wife and children) thus providing considerable argument for the estate assets to pass free from death taxation at least to the decedent's wife and dependent children.[5]

For those risk-enterprise families who have not been supported by the receipt of capital from sources beyond those involving their own efforts, there remains only one source of capital: foregone consumption. One of the simplest of economic principles is thereby demonstrated, that INCOME = CONSUMPTION + SAVING, and SAVING = INVESTMENT. This simple principle amply demonstrates that the incidence of death taxation is upon the family of the enterpreneur, where the capital represented by the taxable estate has been created as a result of social and economic restrictions borne by the family.

Such social and economic restrictions are borne during the period in which the savings and capital allocated to the establishment of the family's pool of investment capital has been accumulated. Frequently this pool of investment capital is represented by a business enterprise providing goods and services from which society, and, therefore, the national economy, as a whole, benefit. The higher returns from those business enterprises that prove to be successful are attributable as much to the enterpreneur's family as to the enterpreneur himself, for the lack of success involving the loss of the family's savings will be borne by the family as a whole, if not more heavily by those dependent than by the entrepreneur himself.

The possibility of higher returns from the successful enterprise provides one incentive toward the accumulation of private risk capital, but these returns are merely representative of the risks of loss of this capital. To tax this capital, when it

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3 Incidence of a tax is used to describe the settlement of the burden of the tax upon the ultimate taxpayer, while "the process of the transfer of the tax is known as the shifting of the tax" (from E. R. A. Seligman "The Shifting and Incidence of Taxation", p. 1); also from Seligman (p. 3) "through the process of shifting, the taxpayer escapes the burden of the tax."

4 *foregone consumption* — savings requiring self-denial.

5 The 1966 "Report of the Royal Commission on Taxation" defends this concept, but fails to deal adequately with the problems of estate liquidity when the estate is passed out of the "Family Unit."

passes among those members of the family whose social and economic sacrifices have made its creation possible, results in these sacrifices having been undertaken for the benefit of others unwilling to restrict their consumption. The destructive effect of inflation on the savings of those whose goal is the accumulation of a pool of investment capital,* whether destined for employment in a business enterprise or otherwise, can neither be ignored nor be taken lightly, for the effect is that of the state rapidly displacing the individual as the major creator of capital. While modern government economic policy appears to have moved toward the reduction of the cyclical problem of unemployment of both human and capital resurces, the price paid is that of reduced productivity and reduced private sector incentives toward saving, and, thus, capital formation. If this trend continues to its natural conclusion, the problem of determining the desired level of death taxation and the size of exemptions, as well as the social, political, economic and legal implications, will be automatically extinguished along with the private capital on which these death taxes are levied.

Returning to the study of those estates which have been accumulated beyond the initial embryo stage involving minimal social and economic sacrifice by the entrepreneur or his famly, that is through business and/or investment acumen involving minimal personal financial risk, a second set of social and economic circumstances prevail.

Capital comprising these estates has not been created through the foregone consumption of the entrepreneur or his family, but through the successful assembly of the small savings resulting from the reduced consumption of others. This reduced consumption and resulting increased savings will also arise voluntarily from employees through the successful coordination of their efforts to produce a profit. Socialists will argue that the profits accruing belong to the employees as wages for their efforts. Capitalists would argue (though surprisingly few of them do) that the profits accruing belong to the business, after the entrepreneurial rewards for administrative success are looked after, and that the lot of society as a whole is improved through the future employment of the capital created from these accumulated profits. Socialists would, therefore, leave the responsibility of savings and capital creation and its productive employment to government. The test of whether the private or government sector of the economy should occupy the role of the creator of capital through savings accumulation should, logically, be one of comparative productive efficiency. It is left to the reader to draw his own conclusions, but in doing so a study of current political and economic trends and conditions prevailing in other industrial societies should not cause the task to be a difficult one.

Accumulation of savings and, thereby, the creation of capital, by the private sector, as experienced at this time in North American and other Western societies, leads, inevitably, to the control and/or ownership of large amounts of capital by individuals. While considerable social prestige is attached to such individuals, considerable social pressure has resulted in seizure by the state of much of their income while living and of their capital at death.

Should the latter seizure prevail? We have heretofore examined the case of the estate created from savings derived directly from consumption foregone by the entrepreneur and his family, and concluded that the taxation of these estates when passed between members of the immediate family who have forestalled their consumption to enable their creation is socially unjustified and represents confiscation of capital from the individuals immediately and directly responsible for its creation. A full exemption from death taxation, between such individual family members has, therefore, been included in our recommendations, insofar as the estate is comprised of a private business.

While such a full inter-family-dependent exemption appears justified in the estate created from family savings, is such an exemption justifiable where the estate has arisen from profits derived from successful capital accumulation through the profitable coordination of employee productivity and the investment of the small savings of many investors? We believe that there is as

* See — *a Progressive Tax Structure plus Inflation — The Tax-Collector's Dream*, p. 19.

much justification in the second case as there is in the first, for two reasons:

1. Avoidance of capital dissipation through maintaining estate assets intact.
2. Potentially increased government revenue through higher productivity in the private sector generating increased incomes.

If the savings function is not to be absorbed by inflation, and private business is not to be absorbed into the large corporations, tax policies must be developed by which private business be perpetuated. While the "spend-thrift heir" is notorious, being unproductive and socially ostracized, he is less frequently encountered than is commonly believed. The typical successor is one who looks upon his receipt of a legacy through an accident of birth not as income to be spent for consumption, but as capital to be employed productively, thereby complying with the socially and economically desirable objective of maximizing productivity. Only through productivity being maximized, whether the productive resources are owned privately or by government, can national wealth be also maximized. And ample evidence points to the major role that the private sector plays in this task.

Are we to sacrifice, even partially, maximum productivity, from which we all benefit, simply because the control of the productive resources rests in private rather than government hands? "Control" rather than "ownership", is here used advisedly, for "ownership" connotes "enjoyment", whereas the high marginal rates of Income Tax charge those with high personal income with the responsibility of providing an increased degree of financial support of government. While confiscatory levels of death taxation serve to force the entrepreneurial individual into the employ of the large corporation through the elimination of the private enterprise, high marginal rates of personal Income Tax assure the retention and reinvestment of profits of the enterprise in order to maximize its growth.

It is, indeed, difficult to accept the contention that the estate received by the unenterprising successor should be received free from taxation because he was fortunate enough to be born at the right time and to the right parents, but equity and administrative efficiency dictate such freedom from death taxes if those enterprising individuals who contribute immeasurably to society are to be provided the capital with which to increase national productivity. Nor can it be concluded that society is the worse off as a result of a successor's non-commercial employment of his inherited wealth if such wealth makes possible the development of artistic or scientific talent from which society as a whole may benefit. Only, then, where the successor adds nothing to the benefit of society, can it be concluded that society is improved by confiscatory rates of death taxation coming on top of high marginal rates of Income Tax. Here, too, the bequest may serve the economic end of keeping the unproductive successor from welfare.

If one concludes that an absence of death taxation, or the application of a non-confiscatory rate schedule, discriminates in favour of the wealthy, let it also be concluded that it discriminates in favour of the maximization of productivity through the maintenance of productive resources intact. If one concludes that the absence of death taxation discriminates in favour of "the idle rich", let it also be concluded that our tax-supported welfare legislation tends to discriminate by rewarding our citizens of marginal productivity.

TAX HAVENS AND FLIGHT OF CAPITAL

The thought of enjoying perennial warmth and balmy breezes by escaping to the sunnier climes of some desert island has great appeal for those experiencing a Canadian winter. Add to these geographic attractions by assuring freedom from income tax and inheritance taxes, and there may be conjured a vision of a true utopia.

Such attractions do, indeed, exist in some of the better known tax haven countries, yet few Canadians have succumbed to the enticements offered. Those who have done so, however, possess millions of dollars of personal wealth, much of which has been acquired in Canada and remains invested in Canadian enterprise. Despite the attractions of climate and tax relief, there are several major factors preventing a general exodus from Canada, the most important of which may be stated thusly: warmth, balmy breezes, and freedom from taxes do not, in themselves, create a society. The attractions of Canada, comprised of viable business, family, and social involvement, are almost totally absent within the tax haven countries. While such Canadian attractions remain within a very few hours air travel, the individual wishing to avoid taxes through his adoption of a tax haven country must limit the period in which he sojourns to Canada if he is not to impair his foreign domiciliary and/or residence status.

Nor does the absence of taxes, both income and death, necessarily imply a low cost of living. Government, to exist, must be supported through one form of taxation or another. To use The Bahamas or Bermuda as an example, import duties, imposed heavily upon virtually every commodity (with the notable exception of liquor and perfume) assure the continuity of a reliable source of government revenue, with the result that those receiving only modest investment-based income find Canadian residence the more economic alternative, despite taxation.

Not to be ignored, in contemplating the adoption of a tax haven country as a place of residence and/or domicile, is the source of continuing income. If investments in government and publicly traded corporate securities are depended upon, no great problem exists, for no personal involvement in management is necessitated, but Canada, itself, falls into the tax haven classification in such cases (in so far as Income Tax is concerned) through the 20% dividend tax credit afforded individuals on their receipt of Canadian corporation dividend income.[1]

The emigration of more Canadians to tax havens is similarly stifled by the necessity to maintain the estate owner's management ability in the locale in which he carries on his business. The controlling member of a large, and usually publicly owned, business enterprise employing professional management, on the other hand, not finding it necessary to be directly concerned in day-to-day operations, is thereby afforded the opportunity to flee heavy income and inheritance taxes by acquiring tax haven resident and domiciliary status.

The smaller and moderate sized privately-owned business enterprise, requiring the personal involvement of a controlling member, largely prevents the flight of the owners of such enterprises from Canada to the tax haven countries. Thus, small and moderate sized estates, being comprised substantially of personally managed business enterprise, bear a relatively higher death tax burden than do the exceptionally large estates, many of which have become controlled from tax haven countries.

The strain of this potential death-tax burden upon such privately-owned businesses, coupled with the tax-haven income tax status of capital gains and dividend income in Canada, has contributed to the liquification of Canadian-domiciled estates through the sale of such private businesses, in contemplation of death taxation. The list of major sales of Canadian companies over the period 1964 through 1966 as presented on pages 28 and 29 provides an insight into the extent to which pri-

[1] When investment in foreign or exempt Canadian government securities (e.g., Government of Canada bonds issued on or before December 20, 1960 and bonds, etc., of a governmental body in Canada issued after April 15, 1966) is significant, a tax-haven based intermediary, wholely-owned by a Canadian parent corporation, will provide advantages of income tax minimization not otherwise available.

vately-controlled corporations are being absorbed by large corporations, many of which are foreign-controlled.

Following common law established through court precedent, Canadian death taxes present the would-be "dodger" with a bewildering array of procedure in order to establish either taxability or avoidance by employing the opportunities available through the medium of a tax haven country. Whereas the concept of residence pertains to income and gift tax, the concept of domicile pertains to death taxes, whether imposed under the terms of the Estate Tax Act or the Succession Duty Acts of the provinces of Ontario, Quebec, or British Columbia.

Each of these provinces imposes succession duty in respect of transmissions of real and personal property having a situs within the province upon the death of a provincially domiciled individual, and Ontario and British Columbia in respect of transmissions of extra-provincial personal property transmitted to persons within Ontario and British Columbia. Similarly Estate Tax is based upon the domicile of the deceased and the situs of his assets.

To effect an avoidance of death duty, therefore, requires the adoption of a new domicile in a tax haven country. Since a person's domicile may be simply defined as the country (or province) in which the person maintains his home and intends to reside permanently, the adoption of new domicile in a tax haven requires the establishment of permanent physical residence. Even after taking all necessary precautions to sever direct personal connections from the country of exodus, the emigrant can never possess absolute assurance that his new domicile will be accepted by his former country of residence. Attachment of assets in his former country, if such assets remain invested there, can arise to satisfy tax liabilities imposed by that country, as a result of failing to break the ties of his domicile of origin. In essence, therefore, it may be concluded that unless the stakes are very significant, the social and economic costs of fleeing to a tax haven, to avoid death duties, outweigh the advantages to be gained.

Those few who have fled, and become tax haven domiciled, represent a significant aggregate net worth, and death duty avoidance. While all such persons wish to avoid death duties, the social costs to them are immeasurable. Many have returned to Canada, choosing to have their estates bear the tax burden, rather than continue to suffer social ostracism. Some of those who remain are embittered "by the political and economic deterioration of Canadian government policy"[2]; others possess feelings of guilt, being morally censurable, though legally not so.

Proposals to deal with the estates of former Canadians usually take the form of tax treaty suggestions. Rignano[3] was a proponent of such a means of countering death duty avoidance. Other similar recommendations are heard periodically. Such proposals display an unusual degree of naivety. What makes a tax haven? Simply an economy that is good for little else. The Bahamas provides an excellent example. There is little industry (other than tourism), natural resources or agriculture. Thus, to attract commerce, reliance must be placed upon the offering of unique services: tax-free domiciliation of people and corporations provides an excellent basis for thriving international banking and trustee services. The Pindling government of The Bahamas placed particular emphasis on the continued maintenance of a tax-haven status when it was successful in overthrowing the many-years-established government of Sir Roland Symonette early in 1967. Little hope, therefore, can be given to a country seriously disrupting its own economy to assist another state in its tax collections.

Of far greater significance than lost death duties, would be the flight of capital that is believed to accompany the flight of investors possessing that capital. This belief is founded neither upon investigation nor upon logically based reasoning. Capital does not seek a haven country when the opportunities for investment are restricted by a lack of resources and markets. Investment of Canadian capital in The Bahamas, for example, has been restricted largely to three areas of operation:

2 The view of an ex-Canadian Bahamas resident.

3 Rignano, Eugenio, *The Social Significance of The Inheritance Tax*. New York: Knopf, 1924.

1. tourism;
2. interntional banking and finance; and
3. real estate development, particularly catering to wealthy retirees.

"Capital is not quite the 'shy bird having no country, but building its nest where it can rest in security' that opponents of high tax rates have described; rather it is like a Greek course that cries often loudly that it will depart, but rarely does so and then only behind the immediate scenery."[4]

Through the enactment of *The Estate Tax Rebate Act* on March 30, 1967, the province of Alberta has become somewhat of a tax haven within Canada. Alberta's share (75%) of the federally-collected Estate Tax is to be rebated to the estates of persons domiciled in Alberta which have borne the tax. As a result, Alberta's provincial revenues will be reduced, in the year ended March 31, 1968, by approximately $5 million. Revenues from this source in 1965-66 totalled $4,941,000.[5] as compared with Ontario's revenue from its succession duty and share of the Estate Tax of approximately $62,060,000.[6]

Included in the motion, tabled before the Alberta Legislative Assembly on April 13, 1966, was the following:

> "Whereas millions of dollars are lost to the Canadian economy through individuals establishing domicile outside Canada in jurisdictions where estate taxes are not imposed, ... "

The stated aim of the Alberta legislation "is to discourage transfer of Alberta estates to areas such as The Bahamas which do not tax estates and are therefore attractive havens for Canadian capital."[7] Premier Manning, upon being questioned, stated, however, that he had no accurate estimate of the capital loss due to estate taxes but said the number of people taking measures to avoid estate tax is increasing every year. Research into the extent to which tax havens are being utilized, contributing to the observations and recommendations of this report, do not support, to any significant degree, the allegations that Canada is experiencing a death-duty-caused flight of capital. In fact, no evidence of wealthy Albertans acquiring domicile in a tax haven country was encountered.

From research, experience, and investigation, it may be stated that, generally, capital seeks investment opportunities known to its possessor after consideration of the risk relative to potential returns has been appropriately examined. Whether capital continues to be invested in Ontario, or Canada as a whole, will depend upon the risks, as determined by the political, social and economic climate (of which taxation policy forms an important part), relative to the opportunities for profit presented the investor, whether he is domiciled in Canada, a tax haven country, or elsewhere. That is not to say that death duties do not affect capital investment in Canada; their effect on the movement of capital into or from Canada is not, however, yet significant.

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[4] Schultz, Wm. J., Ph.D., The Incidence and Economic Consequences of the Inheritance Tax, Houghton Mifflin Company, The Riverside Press, Cambridge, 1926, p. 320.

[5] Source: Calgary *Herald,* April 1, 1966.

[6] Source: *Provincial Finances, 1967,* Canadian Tax Foundation, Toronto 1967, p. 208.

[7] The Financial Post, "Alberta backs Carter on call to kill estate taxes", February, 1967.

GIFT TAX

The primary purpose of imposing a Gift Tax is that of preventing an avoidance of death taxes through inter vivos gifting.* Accepted as such, the gift tax must be considered a pre-payment of death taxes.

Acceptance of "ability to pay" as a basic concept of taxation policy would prescribe a gift tax rate structure in which recognition is given, not only to the value of the gift, but also to the net worth of the recipient and the expected period of enjoyment (i.e. life expectancy) of the recipient. Needless to say the administrative costs attributable to such a concept applied to gift tax (or death taxes for that matter), would prove sufficiently expensive as to be impracticable.

Present gift tax legislation adheres only to one of the composite parts comprising a tax based upon "ability to pay": the rates increase with the size of the gift. No consideration is given to the net worth of the recipient nor to his expected period of enjoyment.

The exemptions afforded under present gift tax legislation, tied as they are to the donor's taxable income, and the income tax attributable thereto, not only discriminate in favour of those receiving unearned income, but also present fiscal traps for those unwary taxpayers and their advisors not careful to weave their way through the intricacies of legal maneuvering in order to gain compliance with the terms of the exemptions. An individual enjoying a taxable investment income of $20,000 per annum from dividends of Canadian corporations is afforded a basic exemption from gift tax of $8080. Another individual whose earned taxable income is $20,000 per annum, however, is afforded a basic exemption from gift tax of only $7599. In addition to the detailed compliance necessitated by the terms of the so-called "once-in-a-lifetime gift" (the gift must be residence *property,* not cash, when to a spouse, or property used for farming purposes when to a child), the exemption of any number of gifts not exceeding $1,000 to separate donees provides a perfect example of the conditional exemption.

A gift of $1,000 exactly to one individual, once the basic exemption has been exhausted on other individuals, attracts no tax. A gift of $1001 attracts tax of $100.10, however. The tax is one hundred times the amount by which the gift exceeds the exemption.**

Gifts, inter vivos, bear a lower rate of tax than bequests made at, or in contemplation of death, the gift tax rate structure being considerably lower (10-28%) than Estate Tax rates (10-54%).

This discrepancy between the rate structure of the gift tax section of the Income Tax Act would appear to provide a most fruitful avenue of death tax avoidance. Yet very little avoidance is undertaken by taxpayers utilizing this avenue.

Gifts fall into three categories: gifts "causa mortis" (i.e., made on the death bed); gifts made in contemplation of death, and inter vivos gifts. Inter vivos gifts, alone, are potentially subject to gift tax rather than death taxes. Gifts "causa mortis" and gifts made in contemplation of death, being obvious attempts to substitute the lower rates of gift tax for the higher rates of death tax, are taxed under the death tax statutes.

A significant reduction in Estate Tax can, however, be effected in large estates under present Canadian federal legislation through undertaking substantial gifts in contemplation of death and paying the gift tax attributable thereto. Being gifts made in contemplation of death, Estate Tax is applied to the value of the gifts, and the gift tax paid is credited against the Estate Tax levied. But the estate no longer includes the gift tax paid, thus Estate Tax attributable to the amount of gift tax paid is avoided. Estates subject to maximum rates of tax at death may thereby avoid as much as $151,200 of Estate Tax through a donor undertaking a gift of $1,000,000 in contemplation of death.

* *"inter vivos gifting"* is legal phaseology for the making of gifts during the lifetime of the donor.

**Until the implementation of the "notch provision" of the Ontario Succession Duty Act and the former Dominion Succession Duty Act a somewhat similar inequitable result prevailed in estates only marginally dutiable.

There exists a definite reluctance to utilize the opportunity to minimize or eliminate Estate Taxes and Succession Duties through the payment of a relatively lower rate of gift tax, attributable almost wholly to the acquisitive nature of the estate owner. There are, of course, other motivating factors which act to discourage inter vivos gifting, the most important of which is uncertainty as to the future financial needs of the estate owner. Such uncertainty, along with the lower rates of tax attributable to smaller estates, provides a plausible explanation for the predominance of the number (as distinct from the amount) of gifts undertaken from large estates. The following table illustrates this trend in the United States.

TABLE A

PERCENTAGE OF ESTATES
Reporting "INTER VIVOS" Gifts
in The UNITED STATES (1957 and 1959)

Size of Estate	Number of Estates	Percentage Reporting Inter Vivos Gifts
($000's)		
Under 900	99	29%
$ 900-1,000	137	26
1,000-1,250	523	48
1,250-1,500	381	55
1,500-1,750	236	60
1,750-2,000	181	69
2,000-3,000	317	67

Source: Carl B. Shoup, *Federal Estate and Gift Taxes,* The Brookings Institution, Washington D.C., 1966 p. 20.

Preservation of capital acts as a far greater motive toward retaining estate assets than is commonly thought, and is directly related to the acquisitive nature of the estate owner. Sociologists will have little difficulty in identifying the retention of control over assets created and accumulated during a lifetime as an important factor motivating against the disposal of such assets through inter vivos gifting.*

The acquisitive nature of creative individuals, and the power that it produces when the accumulation of a fortune is achieved, is not readily modified. There exists an unwillingness to part with any significant part of this power exercised through control over productive resources, notwithstanding the fact that the beneficiaries of such control, and the power which it yields, may be the ultimate recipients upon the death of its interim possessor. With the passage of power to control and acquire, there passes also one's purpose in life. It can be expected that the creative individual is unwilling to "give up the ghost" and admit mortality, at whatever age.

Gifts, inter vivos, are avoided to a significant degree since there is involved not only the gift of capital but also the gift of the income that this capital generates. While disposal of both capital and the attendant income should not act as a deterrent to undertaking gifts from large estates, there exists a definite and understandable reluctance on the part of owners of moderate estates to divest themselves of capital, or control over capital, that would result in a divestiture of income. Resulting from the desire to maintain control of estate assets as well as the desire, in moderate estates, to maintain income, there has been a proliferation of schemes designed to "give the cake away while maintaining the privilege of eating it too, if needed by the donor." Such schemes, frequently necessitating the use of trusts and holding companies, while both expensive to establish and to administer, continue to grow in number and complexity as legislative restriction advances.

Rather than attempting to close their grasp on the more adventuresome taxpayer even further through tighter legal control, legislators could do worse than re-examine the factors contributing to the proliferation of such schemes. The desire to assure the unimpaired continuation of a private enterprise ranks high among these contributing factors and the national interest would be served through assuring a means by which this objective may be more readily achieved.

In addition to the desire to maintain control and/or income, provisions of the Income Tax act as a deterrent to inter vivos gifting when the donee is the wife, or any under-age-nineteen child, as the donor must give up all income from the capital given for the gift to be complete; but the liability

* See Cheng, Grant and Ploeger "Ontario Estates in 1963-64", (study prepared for the Ontario Commission on Taxation), p. 13.

for the payment of tax on that income, when benefitting the donor's spouse or any under-age-nineteen child, remains with the donor thus reducing his after-tax income even further. Here, too, legal means of avoiding this provision of the Income Tax Act are available to those willing and financially able to afford an expensive and complex assembly of their assets.

The proliferation of charitable foundations experienced in the United States, which has served to perpetuate family control over some very substantial industrial and commercial empires, has not been repeated in Canada. In Ontario, at least, it is not expected that such industry - controlling foundations will come into common usage owing to investment restrictions imposed by the Charitable Gifts Act of this province.

In general, the forces operating to encourage the building of a large estate—prestige, power, status—similarly act as deterrents to the destruction of the estate or to the loss of control over its functions. An estate, all too often looked upon as an inanimate aggregation of capital assets, is seen by its creator and owner as a productive enterprise involving a vigorous and profitable coordination and control of human effort. The loss of this control, and the power and status that it provides, prevents the owners of large estates from undertaking heavy inter vivos gifting, despite the death tax advantages that such gifts would assure. Evidence of such an attachment to control over one's capital is provided by the collection of heavy levies of death taxes by the government of Great Britain, notwithstanding the absence of a tax on inter vivos gifts. It is therefore, recommended:

Recommendation No. 3

That Ontario continue its policy of not taxing gifts unless the federal government should vacate that field.

DEATH DUTY — INCOME TAX INTEGRATION

It has been stated that the morals of society provide emphatic justifications for death duties in one form or another. The argument usually centres around which tax and in what degree. Rarely is it argued that death duties should be abolished.

Two such justifications for the imposition and continued maintenance of death duties are put forward: equity of opportunity and equity within a progressive income tax structure. Why should capital receipts be received free from tax when earnings are subjected to highly progressive rates of income tax? Why indeed, should such gratuitous receipts not be taxed at rates exceeding those applied to earnings? Rignano[1] would have had them taxed at 100% in the third generation. As a result a grandchild would receive nothing of the fortune accumulated by his grandfather. However, lacking such inheritance, there would be no income tax payable, the factors of production becoming owned and controlled by the state. Economic power would thus come to rest in the hands of politicians and their adherents.

Inclusion of bequests in a common tax base, as income, or their taxability at even higher rates, would be inequitable unless an intraspousal exemption* is afforded, and additional provision is made for other dependents during their period of dependency. Perhaps some justification on grounds of equity may be found for such an argument, particularly in those situations in which the bequest is in cash or highly liquid securities. Where, however, the bequest is not liquid and not readily and economically marketable, its inclusion in income would prove most inequitable and destructive of capital. Coming on top of earned income, even the opportunity to spread the tax liability over a period of as much as ten years would prove to be onerous for the recipient of a non-cash bequest if the capital received is to remain intact. (Under prevailing income tax rates, payment of $100,000 of death taxes from after-tax personal income of 6% interest over a period of ten years, would necessitate an increase in an individual's personal taxable income from $12,000 per year, for example, to $42,670 per year if the same income and living standards are to be maintained. The additional $30,670 annual payment of tax and interest would be required to be generated, in most cases, from the inherited property.)

The concept of integration of death duties, gift taxes, and income taxes at common rates applicable to all receipts, although receiving renewed publicity as a major recommendation of the Carter Royal Commission on Taxation (1966), is not, in itself, new. In 1955, A. M. Moore, Research Associate, Canadian Tax Foundation wrote, "the inclusion of bequests in taxable income would be only one of several major readjustments needed in our thinking if we are to construct the perfectly equitable tax. The concept of taxable income would have to be extended to include non-monetary income as well as all cash receipts which improve the individual's economic well-being and would further require that the individual be allowed to average his income over his lifetime."[2] There, in a nut shell, written in 1955, is the philosophy of the 1966 Carter Royal Commission report.

Unlike the Royal Commission on Taxation, however Mr. Moore proceeded to the logical conclusion that, "perfect equity is not to be had in this world—nor a tolerable approximation to perfection even on the assumption of unanimous agreement as to the notion of equity."

Generally, we are in full agreement with the recommendations of the Royal Commission on Taxation as they pertain to inter vivos gifts and inheritances insofar as their adoption would permit a complete intraspousal exemption, exemption of provisions for dependent children during their period of dependency, alleviation of double taxation arising through quick succession, and payment over an extended period. We cannot agree with inclusion of gifts and inheritances in a comprehensive tax base, however, being thereby sub-

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1 Rignano, E., *The Social Significance of the Inheritance Tax,* New York: Knopf, 1924.

* *Intraspousal* (or interspousal) exemption — see p. 50.

2 A. M. Moore, *Death Duties: What Can We Do With This Hybrid Tax?,* Canadian Business, September, 1955, p. 49.

Recommendation No. 1

That the federal government be encouraged to review and simplify estate and gift taxation legislation for uniform operation by the provinces as a condition for its own withdrawal from the fields of estate and gift taxation.*

If Ontario is to remain in the death taxation field it would be well advised to consider the complete revision of its Succession Duty Act in order to adopt such a means of applying the simpler provisions of an estate tax while qualifying the legislation as a direct tax as required by the terms of the British North America Act.[3] Failing adoption, by the federal government, of the foregoing recommendation for its withdrawal from the fields of estate and gift taxation, it is recommended:

Recommendation No. 4

That, failing federal adoption of Recommendation 1, Ontario make application to the federal government to qualify as a "prescribed province" in respect to the levying of death taxation in order to increase direct provincial occupancy of the field to 75% and correspondingly reduce federal occupancy to 25% from present levels of equal occupancy.

By combining our recommendation for a complete interspousal exemption[4] with the application of estate tax principles directly upon successors, Ontario would place itself in the position to adopt a rate structure that would assure continuity of its relatively high level of collections from this field. A complete intraspousal exemption might, in itself, contribute to maintenance of provincial revenue from succession duties, at prevailing rates, as the result of the higher marginal rates of duty attributable to the combined estates of husband and wife. As things are at present, the revenue from duties attributable to the two separate estates of husband and wife is likely less than would be provided by rates attributable to the whole, owing to the present practice of avoiding double taxation through the adoption of a "trust-type" will.

Such a complete intraspousal exemption should not, to any greater degree than experienced today, encourage inter vivos disposal of assets by gift. Retention of capital generally appears to be a major attribute of widows, but not so retention of income. Thus diminution of estate capital by a widow is relatively infrequent and, therefore, the duty collected at prevailing rates could be expected to be as great if not greater than if the estates of both spouses were taxed as one. Far too many moderate-sized estates are being expensively administered, with a resulting capital dissipation effect, as a consequence of the encouragement that present succession taxation provides toward the adoption of trust wills.

As presently constructed, the provisions of the Ontario Succession Duty Act function as a sieve for the wary and as a quagmire for the unwary. The treatment of life insurance, which frequently constitutes a substantial part of an estate, provides an excellent example. Life insurance proceeds are dutiable when premiums on a policy owned by another person have been paid by the decedent. Thus, where a husband is fortunate enough to have married a wife having an independent source of continuing income, life insurance owned by and the premiums for which have been paid by the wife will escape duty when received by her. Yet no such relief is afforded to a wife wholly dependent upon her husband's earning ability. Here we have regressive taxation prevailing when progression is the commonly accepted principle of taxation today.

Nor are the mitigating sections of the Act, notably the section allowing an exemption of up to $1,200 per annum for a widow (or certain others) plus a similar sum in respect of dependent children, of great consolation. While affording a definite advantage, the qualifications that must be met before such exemptions become effective require an intimate knowledge of the act on the part of the estate owner or the retention of an advisor possessing such knowledge. With inflation of earnings and the existence of significant employee benefits, pushing large heretofore relatively exempt social classes into the position of possessing dutiable

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* See also page 20.

[3] Subsequent to the preparation of this part of the report, the Ontario Committee on Taxation made a recommendation toward the same objective.

[4] See p. 50.

SUCCESSION DUTIES IN ONTARIO

To some there is little that brings as much pleasure as the nostalgia arising out of a sudden reminder of a fond recollection of the past.

A patch work quilt designed and pieced together meticulously from well-chosen and durable material may be fancied in this manner, yet a more tattered conception cannot be imagined than that of a ragged one frayed from many years of use, and patched and mended during those years in a makeshift manner with ill-fitting material of poor quality. The result is uneven coverage with innumerable gaping holes and thread-bare patches.

Quilted in 1892, the now holey and draughty Ontario Succession Duty Act has been patched and fringed over the past seventy-five years, until today it is a tattered and frayed remnant providing the most complete coverage of those estates whose possessors have likely been similarly attired in relative tatters, while the heirs of the well-advised capitalist are attired in relative splendour, as the benefactors of a carefully planned delivery of their successions through one or more of those gaping holes.

Through the application of initial rates, additional rates, surtaxes, dependent's allowances, increased individual dependent reductions, and notch provisions to transmissions passing and deemed to be passing on the death of the deceased, after deducting specified, but illusive and elusive exemptions, the Treasury of the Province of Ontario was increased by approximately $70 million in 1966, for an administrative outlay of only $823,000[1], slightly more than 1%.[2]

It cannot be said that succession duty in Ontario is not a successful tax from the point of view of the Treasury. Yet the form of the present law is rightfully the subject of severe criticism.

Considerable discussion has prevailed in the past regarding the fairness of legislation which imposes a tax on property passing to a successor as opposed to an estate tax imposing tax on the estate of a decedent. Without reexamining the whole matter in this report, it may be stated that through the process of economic and social evolution the concept of the estate tax has become accepted as the most equitable means of imposing death taxation.

The Ontario Succession Duty Act imposes neither a pure inheritance tax on the successor nor a pure estate tax on the estate of the decedent. Inasmuch as it features both initial rates based upon the aggregate value of the estate passing and certain minor exemptions, the act possesses some of the characteristics of an estate tax. Additional rates, based upon the value of inheritances passing to certain classes of beneficiary, identify the inheritance tax characteristics. The form of the act, being neither "fish nor fowl", labels it as potentially cumbersome and inequitable.

The Ontario Succession Duty Act did not arise, in its present form, accidently. Its original purpose was that of defraying the cost of supporting charities and the revenues raised were allocated specifically through segregated accounting and deposit practices to those ends. Needless to say, an estate tax would have sufficed for these purposes and would have provided a means by which even greater administrative efficiency might have been achieved.

An early attempt was made to have the form of the Ontario Act adhere more closely to the simpler concept of an estate tax. This early form was challenged in the courts, however, and, as it taxed the estate rather than the beneficiary, it was found to be beyond the powers of the province under the terms of Canada's constitution, the British North America Act. Since the provinces are precluded from levying an indirect tax, they are restricted to the levy of an inheritance tax rather than an estate tax. No attempt appears to have been made to determine rates in accordance with estate tax principles for application against the successor upon his share of a decedent's estate. It is therefore recommended that:

1 Source: Data supplied by The Director, Ontario Succession Duties Office.

2 The filing and administrative expenses borne by the estates contributing the duty, however, will be many times the cost of administration to the government.

Recommendation No. 1

That the federal government be encouraged to review and simplify estate and gift taxation legislation for uniform operation by the provinces as a condition for its own withdrawal from the fields of estate and gift taxation.*

If Ontario is to remain in the death taxation field it would be well advised to consider the complete revision of its Succession Duty Act in order to adopt such a means of applying the simpler provisions of an estate tax while qualifying the legislation as a direct tax as required by the terms of the British North America Act.[3] Failing adoption, by the federal government, of the foregoing recommendation for its withdrawal from the fields of estate and gift taxation, it is recommended:

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Such a complete intraspousal exemption should not, to any greater degree than experienced today, encourage inter vivos disposal of assets by gift. Retention of capital generally appears to be a major attribute of widows, but not so retention of income. Thus diminution of estate capital by a widow is relatively infrequent and, therefore, the duty collected at prevailing rates could be expected to be as great if not greater than if the estates of both spouses were taxed as one. Far too many moderate-sized estates are being expensively administered, with a resulting capital dissipation effect, as a consequence of the encouragement that present succession taxation provides toward the adoption of trust wills.

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Nor are the mitigating sections of the Act, notably the section allowing an exemption of up to $1,200 per annum for a widow (or certain others) plus a similar sum in respect of dependent children, of great consolation. While affording a definite advantage, the qualifications that must be met before such exemptions become effective require an intimate knowledge of the act on the part of the estate owner or the retention of an advisor possessing such knowledge. With inflation of earnings and the existence of significant employee benefits, pushing large heretofore relatively exempt social classes into the position of possessing dutiable

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* See also page 20.

[3] Subsequent to the preparation of this part of the report, the Ontario Committee on Taxation made a recommendation toward the same objective.

[4] See p. 50.

estates, universal exemptions should be substituted for the present qualified exemptions.

Similarly, the incidence of duty attributable to jointly or commonly owned real property appears to fall more completely upon the moderate-sized estate where the decedent has not benefitted from a knowledge and continuous awareness of the Act's provisions. A jointly-owned* residence, wholly purchased by a deceased husband, for example, when passing to the surviving widow is fully dutiable. The same residence, under tenancy-in-common,** attracts duty only upon the deceased husband's beneficial interest.

Confusion reigns, also, in respect of the Dependent's Allowance under the Ontario Act. Unlike the federal exemption, the Dependent's Allowance is not an exemption at all, but a tax credit which results in far less relief for the estate (and, in many cases, no relief at all), than does the federal exemption. The Dependent's Allowance certainly does not live up to its stated purpose: "to bring the exemptions—under the Succession Duty Act (Ontario) into line with the exemptions under the Estate Tax Act (Canada)."[5]

While one estate may be caught unaware of the availability of qualified exemptions, and the opportunities available for legal avoidance procedures, another may profit from such procedures. A bequest of a part of an estate to a recognized charity (another qualification), for example, may be burdened with all the liability for Succession Duty, through the appropriate Will provisions, with the effect of significantly reducing the duty payable and passing little or nothing net of such duty to the charity. The charitable bequest has served as a ruse to pass an increased residue to desired heirs.

And what of the heir who receives a benefit, meets his Succession Duty liability, but does not live to gain significant enjoyment from this new found wealth? Ontario subjects the same bequest to further duty upon it passing to subsequent heirs. The Canadian federal government, on the other hand, has seen fit to include in its Estate Tax Act a "Quick Succession" allowance, whereby rates are applied to only one-half the inherited value should a successor's death occur within the first year, increasing ten per cent per year until the full value of inherited property is again taxed after five years have elapsed. We would recommend, should Ontario continue to levy succession duty in its present form, if at all, that a similar provision to deal with "Quick Succession" be adopted as part of Ontario's legislation.

Following World War II it was proposed that the field of death taxation be administered by the federal government exclusively, the provinces to receive an annual rental in exchange. While the other provinces agreed, Ontario and Quebec remained in the field, and British Columbia has since returned to it. Alberta, on the other hand, has adopted legislation to rebate its "rental" to the estates from which it has been collected. Ontario argued that it should be the federal government which vacates the field of death taxation as "its continued use of a field that yields only 1.4 per cent of its total revenue is inadequate justification for the complexities and tax problems that result from joint occupancy."[6] Experience has demonstrated, however, that the complexities and tax problems that have arisen in Ontario, in respect of death taxes, since adoption of the Estate Tax Act (Canada), are traceable largely to the terms of The Succession Duty Act (Ontario). Acceptance of the suggestion put forward by Ontario to the federal government would do nothing to reduce these complexities and problems. "The Estate Duties of the Canadian Provinces, in their straining toward greater justice in the matter of collateral graduation and progressive rates on the share received by the individual beneficiary, have achieved a bewildering complexity far exceeding that of the most poorly drawn American Statute."[7]

Ontario's Succession Duty Act is a perplexing product of the inertia that inevitably surrounds a piece of established legislation. Its adherence to a

* *Jointly-owned* — property passing automatically by survivorship.

** *Tenancy-in-common* — co-ownership of property which, unlike jointly-owned property, enters the estate to be dispersed by the will of the deceased.

[5] Note of explanation to the Succession Duty Amendment Act, 1959.

[6] Allan, James N., Treasurer of the Province of Ontario, quoted in the Toronto Daily Star, February 25, 1959.

[7] Schultz, Wm., Ph.D., *The Taxation of Inheritance*, Houghton Mifflin Company, The Riverside Press, Cambridge, 1926, p. 214.

progressive rate structure is ill-founded upon the concept of collateral graduation (i.e., relationship discrimination) producing the dilemma of identical bequests bearing different amounts of duty. Complete abolition of the present act is long overdue. If revised legislation is to be substituted, rather than the province accepting its share of the federal estate tax, then it is recommended that this revised legislation incorporate the following principles:

Recommendation 5

That Ontario introduce legislation providing for complete interspousal exemption, i.e., that all property passing on death to a surviving spouse be exempt from transfer taxes, but be aggregated with property of the survivor and subjected to transfer taxes at the death of the survivor.

Recommendation 6

That relationship discrimination be eliminated through adoption of a rate schedule based upon the size of the estate (this could be federally determined), or based upon the size of the bequest but applied over its full period of enjoyment by the heir.

Recommendation 7

That transfer tax rates applying to the same estate or bequest within a period of five years be reduced by 50% if re-applied within one year, by 40% if within two years, by 30% if within three years, by 20% if within four years and 10% if within five years.

Recommendation 8

That there be provision for payment of duty by instalment, with interest on the outstanding balance, over a period determined by the size of the bequest, unless rates are applied during the full period of enjoyment.

OWNERSHIP OF ONTARIO INDUSTRY

There can be little doubt that present Canadian legislation contributes to the passing of control of domestic industry to non-Canadian owners.

Forced sale resulting from the pressing demands of death taxation, or carried out in contemplation of death, bulks large as a causative factor in such sales. The prominent position that Ontario holds, relative to the balance of Canada, should provide ample reason for the 4% of provincial revenue raised from succession duties to be found through other channels or through measures of government economy. If, however, social and economic pressures dictate continued provincial occupancy of the death tax field, measures to mitigate the effect of death taxes on private business must be adopted if such businesses are to remain a significant part of our economy.

Three factors are particularly pertinent to the private company upon the death of a principal or owner which are not usually of concern to the public company; (1) continuity of management; (2) marketability, and; (3) financial leverage. Any one of these factors alone will drastically affect the course of a private business in such an eventuality. Lack of advance consideration of each may result in the destruction of a lifetime of creative effort. Death taxes, unlike other forms of taxation, being a levy upon accumulated capital rather than upon a flow of cash, accelerate this destruction through giving rise to cash demands from non-cash assets.

Since liquidity within any business is almost never conducive to maximum productivity, cashable assets are minimized. In the private company, "tight money" is accepted as a normal bridle on business activity; desirable financial ratios are infrequent; increases in borrowed funds are often impossible to make. Yet personnel and capital are vigorously and productively employed, thus contributing to our provincial and national well-being. Since retained earnings are the chief source of capital for the continued growth of an expanding private business, interruption of this growth, precipitated by the necessity of paying out earned surplus to meet death tax liabilities is not only detrimental to the economy as a whole owing to the retractions necessary, but, indeed, all too frequently tolls a death knell on the continuity of the business itself, thereby disrupting the employment of both its capital and its personnel.

Present tax legislation, in fact, provides an inducement to dispose of private business interests at death, or in contemplation thereof. The inability of family or employees[1] to finance the purchase of the business is made the more difficult by the high cost of saving from after-tax personal incomes and by the depreciation of such savings proceeding from inflationary monetary policy. Tax-free realization of one's cumulative labour, as represented by business ownership, is a far more acceptable alternative to many business owners. Their choice of the highest bidder it not, and cannot be expected to be, tempered by sentimental attachment to a continued Canadian or Ontario identity for their business, or to feelings of guilt arising from inroads on our sovereignty. The business owner thereby "solves his death tax problems and cashes in on the accumulation of years of (corporate) earnings, without subjecting them to the confiscatory process of double (income) taxation."[2]

"It would probably be difficult for statisticians or economists . . . to measure the deterring influence exerted upon the expansion of a small business either by the threat of events following on unexpected and untimely death, or by the cost of providing for these events in advance. But that this influence operates in some degree is surely not open to question."[3]

Most owners do not relish the prospect of disposal of their businesses, but the knowledge that impending taxes demand delivery of cash within

[1] The United States has given recognition to the problem of financing the purchase of a private business by employees or other persons unrelated to a decedent by accepting a price negotiated with the decedent as the value for purposes of determining U.S. estate taxes.

[2] Watson, J. Graeme, President, E. & S. Currie Limited, *Estate Tax as It Affects Smaller Businesses,* Industrial Canada, July, 1963, p. 126.

[3] Ibid.

six months of death forces their hand. Realistic assessment of the problems to be faced by executors in raising funds cinches the decision to sell. Lack of realization contributes to conditions frequently culminating in forced sales at depressed prices. Ownership frequently passes to foreign companies, thereby putting an end forever to death tax collections leviable upon the increasing value.[4]

Not all investigators or authors agree that death taxation contributes significantly to the sale of private business however. The authors of the "Death Taxes" study[5] of the Royal Commission on Taxation as well as the commissioners of The Ontario Committee on Taxation Report[6] concluded that death taxation, per se, was not the culprit, and that the problem lay in the area of accumulated surplus. As their points of view cannot be taken lightly, they are included hereinafter.

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[4] Reference to pages 23 and 24 of this report bears out the fact that many Canadian companies are being absorbed by foreign-controlled enterprise.

[5] Smith, John G., Fields, D. B., Mockler, E. J., Study Number 11, *Death Taxes,* The Royal Commission on Taxation, Ottawa, 1966.

[6] Smith, Lancelot, J., Hardy, Eric, McIvor, Dr. R. Craig, Pollock, Carl, and Stapells, R. Bredin, *The Ontario Committee on Taxation Report,* Toronto, 1967.

"A standard criticism of the *Estate Tax Act* is that estate taxes are causing hardship to small businesses, and forcing sellouts to either large corporations or foreign interests or both. This is a serious criticism and if correct it must receive careful attention, leading to a fundamental examinaton of the tax. Elimination of small businesses, through wholesale mergers into large corporations or takeovers by foreign commerce is not, in the author's opinion, in the national interest. They therefore set out to gather evidence to assess the magnitude of the problem. Individuals and corporations responsible for administration of estates were canvassed by the Royal Commission and asked to submit factual evidence of cases where estate tax was the dominant factor in the sale of a small business. While a few specific instances were revealed, in many cases the fundamental reason lay somewhere else than with estate taxes. Such reasons as an offering price too attractive to resist, a lack of management capacity in the remaining family, such as a spendthrift son, a disinterest in the business, or the certain knowledge that the business was on a steady decline, were among the most prevalent. In some cases, a sale does appear to have been made prior to the death of the principal shareholder in anticipation of estate taxes. However, it is the author's view that the Act does not restrict estate planning which could obviate many problems which arise on death. It is open to all to take advantage of this, and it is concluded that even those sales which take place prior to death are often motivated by factors extraneous to estate tax. The subject was investigated in England by a body set up to study national debt and taxation. That group found that, while cases of hardship do occur, '. . . the Estate Duty does not appear to be a major factor tending toward the disintegration of private business.'[7]

"Although this conclusion was reached some years ago in another country, it states accurately our own opinion. In addition, this matter has been discussed with officials of the Treasury Department, Washington, D.C., who state that this complaint is perennial in the United States, but they have absolutely no empirical evidence to indicate that estate tax is a major factor in the sale of small businesses. The whole subject of hardship to small businesses resulting from estate tax is interwoven with the area of accumulated surplus which has been the cause of so much income tax legislation."[8]

Take away the income tax cost of distributing surplus, and solve the death tax problem? Not likely. To reduce the tax cost of distributing surplus does not solve the liquidity problem as the death taxes remain payable often as not from non-liquid assets. Of course the attraction of an income tax-free capital gain is bound to provide an irresistible temptation to many business owners, particularly when the price is right. The straw that tips the scale in favour of the sale is often, in our view, a realization of the cash demands that death taxes will inevitably present.

[7] *Colwyn Report* of the Committee on National Debt Taxation, 1927, Appendix XX, para. 19.

[8] Smith, John G. Fields, D. B., and Mockler, E. J., *Death Taxes,* Study Number 11, The Royal Commission on Taxation, Ottawa, 1966, p. 18-19.

THE ONTARIO COMMITTEE ON TAXATION

The commissioners of the Ontario Committee on Taxation, in undertaking to inquire into and report upon the taxation and revenue system of the Province of Ontario, determined that "there is one characteristic in particular that . . . rises above all the rest," in determining the basic philosophy of the role of government in society, "both because a majority of the remaining characteristics flow from it and because it goes to the core of constitutional democracy. This characteristic is equity."[9]

That this philosophy of the role of government in today's society cannot be successfully refuted is accepted by virtually all individuals. Following from this basic philosophy, the commissioners have concluded that equity in taxation follows from two principles: the principle of benefits received and the principle of ability to pay. Following from the latter principle, the commissioners contend, and we agree, there is justification for progressivity in taxation.

However "our highly progressive tax system, inspired by the example of economically more mature nations such as the United States and the United Kingdom, has increased the difficulty of generating within the country sufficient capital for our needs. Income tax certainly reduces the rate of capital accumulation and death taxes disperse the accumulations that have already been made. Since the strength and growth—and indeed, the very foundations—of our economic system depend upon the willingness and ability of private citizens to accumulate and invest capital, these consequences are held to be anathema. On the other hand, a democratic society such as ours, espousing political equality for all its citizens, cannot permit undue concentration of wealth in the hands of a few. Though differences in wealth will always be with us, extremes of affluence and poverty must be prevented in the interests of a stable society."[10]

Again, we cannot disagree, on matters of principle, with the commissioners. The key words, however, are "undue concentration of wealth", and "extremes of affluence and poverty". In the process of devising a much-improved Succession Duty Act we believe the commissioners have abandoned their own notions of equity and ability to pay by advocating the taxation of concentrations of wealth which are far removed from what may reasonably be considered "undue". In today's society, what constitutes an "undue concentration of wealth"? A million dollars? $100,000? $25,000? Of course, the answer will depend upon one's point of view. It will also depend upon the form in which the wealth is concentrated. For example, $100,000 of publicly traded stocks and bonds can be a far greater asset than $100,000 of stocks and bonds of a small private company. In fact the latter "concentration of wealth" may constitute a liability if it entails responsibility for the private company's operation when its recipient is not equipped to assume that responsibility.

In support of progressivity in a taxation rate structure the commissioners made reference to the economist's law of diminishing marginal utility,[11] that is, the more of a thing that an individual possesses, the less use that individual will have for an additional unit of it. Adherence to this law as a basis for progressivity in death taxation would dictate the necessity for effect being given, in the rate structure, to concentration of wealth possessed by the recipient. In doing so, the commissioners have abandoned their basic principle of equity through assessing the amount inherited at the rate determined by reference to the size of the estate rather than by reference to the recipient's net worth.

On the following page is reproduced the calculations of duties payable on a hypothetical estate in the Report of the Ontario Committee on Taxation. That example can be elaborated upon to exemplify a lack of adherence to the principle of equity as contained in a progressive rate structure. Each of the decedent's 22-year-old daughter and a close friend are the recipient of a $25,000 bequest; duty on the daughter's bequest is proposed at $1,320, whereas that applicable to the close friend would amount to $5,500.

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9 Smith, Lancelot J., Hardy, Eric, McIvor, Dr. R. Craig, Polllock, Carl, and Stapells, R. Bredin, *The Ontario Committee on Taxation Report,* 1967, Queen's Printer, Toronto, Volume 1, p. 8.

10 Ibid, Volume III, p. 132.

11 Ibid, Volume 1, p. 13.

DUTIES PAYABLE ON A HYPOTHETICAL ESTATE

(reproduced from Vol. III, pp. 189-90,
The Ontario Committee on Taxation, 1967)

168. We conclude the discussion of our proposed rate structure by demonstrating the computation of the duties payable by the beneficiaries of a hypothetical estate. After taking into account the deductions for debts, funeral expenses, cost of probate, legal fees and the $6,000 basic deduction, our hypothetical estate has an *aggregate net value* of $200,000. Gifts to the widow in the three years prior to the death of the deceased amounted to $6,000, and these were free of gift tax. No other dispositions were made in that period. The will of the deceased provides that the estate be distributed one-half to the widow, and one-eighth to each of a 30-year-old son, 22-year-old daughter, a close friend and an exempt charity. The duties on the beneficiaries would be computed as follows:

Computation of Beneficiaries' Rate

Aggregate net value		$200,000	
Basic duty on $200,000 according to proposed rate schedule		44,000	
Beneficiary's rate $\frac{44,000}{200,000}$ x 100%		22%	

Computation of Duties

Widow:			
Property passing		$100,000	
Dispositions		6,000	
Aggregate taxable value		106,000	
Deduct: basic deduction	6,000		
exemption	75,000	81,000	
Net taxable value		$ 25,000	
Duty on $25,000 @ 22%			5,500
Son—30 years of age:			
Aggregate taxable value		$ 25,000	
Deduct exemption		10,000	
Net taxable value		$ 15,000	
Duty on $15,000 @ 22%			3,300
Daughter—22 years of age:			
Aggregate taxable value		$ 25,000	
Deduct exemption		19,000	
Net taxable value		$ 6,000	
Duty on $6,000 @ 22%			1,320
Friend:			
Aggregate taxable value		$ 25,000	
Deduct exemption		nil	
Net taxable value		$ 25,000	
Duty on $25,000 @ 22%			5,500
Charity:			
Aggregate taxable value		$ 25,000	
Deduct exemption		25,000	
Net taxable value		nil	
Duty			nil
Total duties payable			$15,620

Each of the above amounts would be reduced by whatever credit is required to compensate for federal estate tax—a reduction of 50 per cent if the present 50 per cent federal abatement continues and a reduction of 25 per cent if the federal abatement is increased to 75 per cent of the estate tax otherwise payable.

We see nothing inequitable about providing a 22-year-old child with a $19,000 exemption. Assume, however, that the daughter has received a prior inheritance from her grandfather's estate of $500,000, and that the close friend is a former school chum of the decedent subsisting as a store clerk. Obviously the principle of equity contained within a progressive rate structure, and embodying the law of diminishing marginal utility, would indicate that the duty applicable to the close friend's bequest, if any, should be some fraction of that applied to that of the daughter.

In respect to the effect of death taxes in Canada upon closely held businesses, with which we are primarily concerned, the commissioners have stated that "it is true that where a person dies with substantially all his assets tied up in a closely held business the financing of his death taxes may present a difficult problem."[12] As has been emphasized earlier in this section of our report, liquidity (i.e. working capital) is a chronic problem for the small private business. It is the exception, rather than the rule, to find a significant amount of liquid funds available either within the business' treasury or in the hands of the business' owners. Despite such lack of liquidity, the non-business assets of the owners are commonly minor in comparison with the value of the business.

The commissioners conclude, as did those of The Royal Commission on Taxation, that, "we are inclined to think that other considerations, than death taxes,"[13] are usually present when a Canadian-owned business is sold to a foreign buyer. "Also, we are impressed with the obligation on every citizen to arrange for liquidity requirements in his lifetime if it is desired that the business be retained in his family."[14]

The arrangement of liquidity frequently entails gifts, in trust, or to intended heirs for the purpose of acquiring life insurance upon the business owner. It is precisely such gifts that the commissioners single out as the target for their proposed gift tax without benefit of the proposed annual exemption. The difficulty of providing liquidity is thereby compounded through subjecting to gift tax the funds set aside, whether through beneficiary-owned life insurance or the establishment of a sinking fund in the form of a trust. Nor, in respect of life insurance, have the commissioners adhered to their principle of equity. The combined effect of the proposed policy-ownership test and the singling out of gifts destined for payment of premiums on beneficiary-owned policies as the only ones not entitled to a standardized schedule of exemptions results in regressive taxation borne by beneficiaries not possessing, or possessing insignificant, independent income with which premiums may be paid. The financially independent wife or child is thereby given the opportunity of greater financial independence, while the impoverished become more so.

The commissioners have recognized the unique requirements of the estate comprised of private woodlots, in the interests of woodland convervation, by suggesting deferment of succession duty payment, without interest, until the timber is cut or sold. There appears to be a very real need for such special treatment.

We believe a special case also exists in the case of private business. Needless to say succession duty leviable upon the value of a private business cannot be deferred, without interest, until some indefinite future date when the business is deemed to have reached "maturity". The commissioners have made a commendable recommendation to permit the Treasurer of Ontario, upon application, to defer payment of duty during specified, but renewable, periods in those situations where it is established that payment within the statutory time would be unduly onerous. Such a provision is already contained within the present act but it is exercisable only upon application and at the discretion of the Lieutenant Governor in Council.

While such a provision for deferment of duty represents a major step toward mitigating the effect of death taxes upon the continued development of private business in Ontario, we believe that this provision should be supplanted by a genuine incentive toward encouraging the continued

12 Ibid, Volume III, p. 197.
13 Ibid, Volume III, p. 198.
14 Ibid, Volume III, p. 198.

development, expansion and ownership of private business within this province. Towards this end we recommend:

Recommendation 2

That where more than ten percent of the issued and paid-up capital of a private Canadian corporation possessing assets of which not more than ten per cent are securities of public corporations or government is represented by shares owned by a deceased at the time of his death, the value of such shares be included in determining the rate of transfer tax to be applied to other estate assets, but such value be exempted from transfer tax unless such shares are sold within a period of ten years.[15]

The commissioners have seen fit to recommend the province's adoption of a gift tax, not in itself for the purpose of raising revenue, but for the expressed purpose of acting as a deterrent to those who would seek to avoid death taxes through undertaking inter vivos gifts. We do not believe the present loss of death tax revenue is sufficient to warrant such an entry into the gift tax field.

Considerable experience in estate planning bears out this belief, as do the statistics on federal gift tax collections. Individuals are loath to part with capital despite the high level of death taxation. Britain, while presently diverging significantly from the norms of North American society, exemplifies a situation in which confiscatory rates of death duty are very successful in their quest for revenue notwithstanding the absence of a gift tax. In fact, public announcement of a family's payment of significant sums of death duty in Britain has become somewhat of a status symbol.[16]

Of course, one may speculate to what extent confiscatory rates of death duty in Britain, resulting as they do in dissipation of capital, have contributed to prevailing economic conditions in that country. Canada, and Ontario in particular, cannot afford to risk dissipation of the capital productively employed within our private businesses.

As has been demonstrated, much conjecture has arisen in respect of the extent to which death taxes are contributing to the sale of private business to foreign owners, thereby affording the opportunity for expatriation of future corporate earnings and domestically employed capital. Excerpts from the comments received from former business owners have been included in Section I of this report to exemplify this trend, and, hopefully to influence its reversal.

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15 Reference may be made to Austrian death tax legislation as a precedent to such legislation.

16 See discussion and accompanying Recommendation 1, pages 20 and 48.

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APPENDIX I

SUMMARY OF DETAILED RECOMMENDATIONS TO THE ROYAL COMMISSION ON TAXATION REFERRING SPECIFICALLY TO ESTATE AND GIFT TAXATION

Many recommendations on Estate and Gift taxation were made in the submissions to the Commission. Over 300 of the submissions were reviewed to provide the following summary:

Number of Proposals	
	(Estate taxation)
17	Recommending increase of the basic exemption.
14	Toward equitable evaluation of corporation shares — in particular, those of private companies.
13	For payment of tax by instalments — eight of which referred specifically to the destructive impact of present regulations on small businesses.
13	Recommending more consideration of the community of interest of spouses.
13	Toward correcting treatment of pensions or annuities — in particular, the desirability of instalment payments during enjoyment.
3	Recommending exclusion from taxable estate of provision for the education of children.
1	Suggesting liberal exemption for investments in private companies.
1	Recommending modification of taxation for the conservation of timberlands.
	(Estate and Gift taxation)
8	Recommending unification. Four suggested provinces vacate; three suggested federal government vacate; one suggested a unified system.
	(Gift)
8	Various recommendations toward modification.

G. F. MacLaren, Q.C. — Estate taxes and succession duties

The brief points out the financial difficulties faced by a small business when its principal shareholder dies. The heavy estate taxes and succession duties, and the need to pay them in cash within six months, result often in the sale of the business to a foreign company or in an amalgamation with another, larger, company. To prevent this trend from becoming stronger with the years, the brief suggests that at least six years should be given an estate in which to pay the duties without penalty but with interest at, say 4% per annum after the first year, the government keeping control of sufficient assets in the meantime. To encourage prepayment of duties before six years, a discount could be given to the estate of say 6% per annum.

In the opinion of the participant, such a scheme would give time for the remainder of the family or group to organize some method of keeping control in Canada and encourage the Canadian-owned control to keep on with the expanding business. The executors could gradually liquidate to the remainder of the family or group, or other Canadians, some of the interest owned by the deceased, over a reasonable time, so that the executors and the Canadian group owners could pay the taxes imposed at death and yet retain control in Canada.

S. A. Bensh — Estate taxes

These taxes destroy the accumulated wealth by taxation and reduce the amounts of money available to would be investors.

Vancouver Board of Trade — Estate tax uniformity

The two types of death taxes prevailing in some provinces are confusing to government and taxpayers and a single estate tax should be imposed across Canada. Also, in order to attract foreign capital, this should be exempted on entry though subject to estate tax in the event of accumulations.

Edmonton Chamber of Commerce—Estate taxes and family businesses

One of the principal factors in the sale of so many Canadian family-owned businesses to large companies, both Canadian and foreign, is the present Estate Tax Act. A Canadian who has built up a prosperous business in which most of his assets are tied up must naturally plan for what will happen on his death. Although he may wish his heirs to carry on his business, he must also recognize the estate tax which his estate will bear, and provide funds to meet it. He is, therefore, only too willing to sell his shares, probably for a capital gain, and realize on his investment. It is often difficult to arrange a sale to members of his family or his employees due to the amounts involved. It is recommended that consideration be given to increasing the estate tax exemptions materially. This would still allow estate tax to fall heavily on the very large estates which probably account for a large part of the present revenue, and would lessen the burden on owners of small or medium sized family businesses. An alternative to this might be to allow very liberal valuation allowances on investments in private companies.

Canadian Federation of Property Owners Association, Ontario Property Owners Association, Property Owners Association of Metro Toronto — Estate tax

The Estate Tax Act should be amended so as to insure that a business established by a Canadian with Canadian capital may be maintained for generations. A combination of estate taxes, succession duties and income taxes on federal and provincial level now taxes the same money four times. The rates should be lowered, and federal-provincial tax relations revised. There should be more time to pay the death duties. Seperate taxes on man and wife should be eliminated; the tax should be collected only when they both die. Valuations of estate often work out in an unfair way; all valuations should reflect cash to the vendor.

The Trust Companies Association of Canada

There are three main objectives in the imposition of death duties:

1. to provide revenue for the government;
2. to provide an opportunity for a final accounting of the financial affairs of the deceased (i.e. to check on income tax and gift tax evasion); and
3. to place limits on the accumulation of wealth so as to equalize opportunities available to individuals.

Historically, the main purpose of death duties was the need for revenue, but today succession duties and estate taxes contribute relatively little to government treasuries, particularly on the federal level.

It is not necessary to levy a tax to ensure a final accounting of the financial affairs of the deceased: this could be accomplished simply by requiring the filing of a return.

The third objective, the social one, must be taken to be the real reason for death taxes today. If this is so it follows that such a tax should be based on a realistic concept of "wealth", and should not involve hardship for dependents. "Hardship" should be viewed in terms relative to accustomed living standards, not arbitrary fixed standards.

Association of Canadian Distillers — Estate tax

The revenue from this tax has averaged only 1.3% of total tax revenues during its existence over 22 years. It is assumed, therefore, that its purpose is to collect arrears of personal income tax which, in effect, is a confession of lax tax administration. Such a purpose, that of imposition of a new tax to police collections from an old tax, is unsound tax policy. In any case, death duties were within provincial competence some 50 years before federal invasion and the federal government should abandon this sphere, because the loss would be insignificant and because such a policy would cement government relations as well as lessen complications for many estates which pay federal and provincial death duties in Quebec and Ontario.

Canadian Association of Real Estate Boards

1. Special tax concessions where the ownership or control is in the hands of Canadians, domiciled and resident in Canada.
2. The Canadian tax climate to be temperate for foreign investors willing to forego control and cool for non-residents seeking to dominate Canadian businesses in which they have invested.
3. Increase of the withholding tax on withdrawals of profits from Canada by non-residents who control businesses. Conversely, the tax to be reduced where participation and control by resident Canadians is more than 50%, thus encouraging foreign investment and Canadian participation.

The Canadian Metal Mining Association — Foreign capital

Since foreign capital will be required for some time yet for mining development, legislation should be designed to encourage domestic investment participation rather than to discourage any capital inflow. Any measures curtailing foreign investment would be unwise and, in view of the dependence of mining companies on foreign capital, the tax climate in Canada should continue to remain hospitable to foreign investors.

Independent Petroleum Association of Canada — Foreign capital and foreign control

Legislation to reverse the Canadian trend of selling out equity interests in domestic industry should be based on incentives which would encourage increasing Canadian ownership. It should not attempt to discourage the inflow of foreign funds. A restriction on foreign inflow would not result in increasing Canadian ownership and could affect the Canadian economy adversely.

The Canadian Institute of Chartered Accountants — Canadian tax environment

The Canadian tax system and atmosphere should be attractive to investment and enterprise, stable, consistent and reliable. Despite the promotion of domestic investment participation, it must be remembered that the Canadian economy is dependent upon foreign investment funds as well as domestic funds.

Toronto Stock Exchange — Complete dividend exemption

Canadian individual shareholders should be allowed complete or substantial income tax exemp-

tion on dividends from Canadian companies. This would stimulate the repurchase and repatriation of equities now in non-resident hands and investment participation by individuals.

Canadian Construction Association

Fiscal policies should be used to help to achieve greater stability in the economic growth rate of the construction program and thereby of the country by such means as the avoidance of taxing capital investment items, especially when economic expansion is desired.

Canadian Chamber of Commerce — Distribution of income

There has been a much wider income distribution than in recent years.

Since government expenditures are increasing, future revenue requirements will be even greater than at present. Also, the rate of economic growth in this current decade is slower than the last so that a greater tax burden will have to be sustained. Therefore, it is important that the "tax mix" should be devised to prevent further impediment to economic growth. The marked broadening of the pattern of personal income points to the possibility of spreading the tax burden over a wider front by reducing personal and corporate income taxes and raising more revenue from such indirect taxes as the sales tax.

Non-resident taxation. The brief goes on to indicate its opposition to tax policies tending to discourage foreign investment and foreign confidence in Canada.

The Canadian Bankers' Association — Estate taxes and succession duties

A study is required of the effects of estate taxes and succession duties on ownership of Canadian industry. Present levels of tax are forcing the sale of Canadian-owned enterprises to foreign interests and relief in this area should be given through a reduction in the rates of these taxes.

Shoe Manufacturers' Association of Canada — Estate taxes

The unreasonably high level of these taxes has been the largest single factor encouraging sell-out of Canadian enterprises to foreign interests and eliminating family businesses.

Investment Dealers' Association — Canadian take-overs by non-residents

The most difficult area for policy decisions is undoubtedly that of take-overs of Canadian business enterprises by non-resident interests. Acquisition of a controlling interest in an enterprise can either take the form of an outright cash or stock offer to shareholders or purchase of stock in the market. In the latter case, it may often be difficult to identify the buyer or his motive. Therefore, an effective system of preventing take-overs cannot seemingly be established without ultimately creating an extensive network of restrictions on capital movements. This would obviously be undesirable.

Death duties payable over a period — From time to time, executors are compelled to make what amounts to forced sales of private companies in order to obtain funds for the payment of succession duties. Frequently the best cash offer can be obtained from a foreign buyer. If death duties could be paid over a period of years, executors of estates containing substantial blocks of stocks of private corporations would be able to negotiate more advantageous sales to Canadian buyers.

Canadian Tax Foundation

In addition to the above observations, the Foundation discusses: . . . . inter-generation redistribution of income by estate taxation and the aspects of reshaping the estate tax to avoid inequities on survivors of the same generation and to minimize effects on the break-up or sell-out of small businesses.

APPENDIX II

COMMENTARY BY DR. A. K. EATON ON THE COMPARATIVE EFFECTS OF INCOME TAXATION ON PUBLIC AND PRIVATE CORPORATIONS

The then Minister of Finance, The Honourable Donald Fleming, upon releasing the news of Dr. Eaton's resignation from the Department of Finance in 1958 issued the following statement: "While Ministers of Finance must take full responsibility for all tax legislation, it is no secret that many of the best features of the Canadian tax system have been founded on Dr. Eaton's expert knowledge and advice."[1]

Few reports on taxation in Canada can be considered complete without reference and recognition being made to Dr. Eaton's posthumously published book, *Essays in Taxation,* from which the following quotations are extracted:

Federal Corporation Income Tax[2] (Canada)

"In Canada corporation income tax takes approximately one-half of the annual profits of a corporation. Personal income tax takes approximately one-half of income just in excess of $25,000 (up to $40,000). Suppose, therefore, that a corporation has a profit of $100, of which $50 is available, after tax, for dividends. If the dividend is received by an individual with an income of just over $25,000, the marginal rate is 50%, which is reduced by the dividend tax credit to 30% so he pays $15 tax on it. So in effect $65 of that $100 profit is taken in income taxes, and the individual recipient has $35 of his dividend left. . . .

"Stated in this manner the facts practically invite the conclusion that with this picture of profit confiscation before him the man with money to invest would be wise to leave it in the bank or buy government bonds. Capital investment in industry would then wither away and die. Rarely, however, does the shareholder in any direct sense decide whether additional investment by a corporation is worth it or not. The shareholder and the company are two very separate and distinct persons.

"In considering a program of capital expenditure the management of a widely-held public company looks forward to the expected improvement in the company's own earnings position and the amount taken out by the corporate tax, and does no look backward and contemplate the fraction after personal income tax left in the hands of the thousands of anonymous owners of shares in the enterprise that it is managing. Consequently, it is not the combined corporate and individual taxes that stand in the way of new investment but only the corporate tax. Shareholders make their own decisions to invest or not invest in shares of a corporation, according to their own inclinations, the tax bracket being one consideration. . . .

"From the foregoing it appears that in the publicly-held company it is merely the corporate rate of tax and not the combined taxes that has a restraining effect on investment decisions, while for the individual investor it is the yield obtainable either on stocks or bonds after the corporate tax has had its effect on capital values The weakened market for equities may, of course, force companies into retaining profits for capital expansion, supplementing them with borrowed money.

"Where instead of being widely held with a well established market for its shares the corporation is essentially a family affair, the influence of taxes can be quite different. If the businessman owns all the shares of a corporation the decisions regarding capital expenditure will be made by one person, the shareholder. It is in this situation that investment decisions are made in the face of the combined effects of both corporate tax and personal income tax. The figures given above showed only about $35 left out of $100 of profit where

[1] Honourable Donald Fleming, Minister of Finance, quoted in the Globe and Mail, Toronto, May 6, 1958. Dr. Eaton was for many years Assistant Deputy Minister and Chief Tax Adviser in the federal Department of Finance.

[2] Quoted from "Essays in Taxation", A. K. Eaton, Canadian Tax Foundation (1966), pp. 59-62.

the residue after corporate tax was distributed as a dividend. The implications of this situation could be quite serious for the prospects of survival of small privately financed businesses.

"In spite of the practical identity of company and shareholder in the family type of corporation with the rather discouraging tax situation facing new investment there are other facts which modify the bleak outlook just presented. In the first place the tax rate on the first $35,000 of profit is only 21% (including OAS). This low rate bracket below the standard tax of 50% was introduced purposely to assist small private businesses. The 21% corporate rate followed by the 20% tax credit for dividends removes almost completely the burden on the shareholder of corporate tax on profits up to $35,000 a year. Less than 20% of taxable corporations in Canada have profits in excess of $35,000 and thus meet the 50% standard rate on the excess or, otherwise stated, over 80% fall within the low bracket where double taxation is almost completely taken care of by the tax credit.

"Even if the effect of the corporate rate of 21% is largely taken care of by the dividend tax credit, distributed profits from the business would still encounter the high personal income tax rates which take half the income received in excess of about $25,000. Thus, tax discouragement would soon be encountered in a growing business if profits were all distributed. The fact is, of course, that in family businesses profits are not as a rule all distributed. Traditionally family businesses grow through the retention of earnings for expansion. It is well recognized that an important objective of owners of closely-held corporations is to build up a business, to accumulate an estate within the corporate framework. It is, therefore, not realistic to accept too fully the idea that personal income tax rates act as a discouragement to new investment in closely-held corporations. *Funds "ploughed back" for growth do not meet the high personal rate structure. High personal rates do mean, however, that more profits have to be distributed in order to leave the chief shareholder enough to live on. Accordingly, they cut into the supply of capital otherwise available for investment.**

"In general, it can be concluded then that tax discouragement to new corporate investment rests solely in the corporate tax and not in the combination of corporate and personal taxes. The exception to this rule is found in the case where the chief shareholder of a closely-held company invests mainly for the purpose of expanding the flow of income to himself and not with the idea of building up a large business by retaining profits. *While it is mainly the corporate tax that is being regarded as operating to deter new investment, it is clear that both the corporate tax and the personal income tax reduce the supply of funds otherwise available for private investment."**

* Italics by editor.

SECTION 3

A SURVEY OF SUCCESSION AND GIFT DUTY SYSTEMS IN WESTERN EUROPE

by
D. VAN DEN BULCKE

INTRODUCTION

It should be stressed from the beginning that this is only an exploratory study. Succession duties and gift duties have received little or no attention from European economists. Most of them still seem to think that "death taxes can raise revenue with apparently less personal initiative and, in fact, force potential heirs to work more industriously; that they have less adverse influence on business and resource allocation than income or other taxes raising equal revenues; that they check the tendency of economic inequality to accumulate".[1]

This survey is intended as a general introductory picture of the systems of succession and gift duties of some major European countries and hopefully will be useful as a basis for further work in this field. The first part discusses the six Common Market Countries; the second part takes into account five other European countries which are either members of the European Free Trade Association or applicants for association with the E.E.C. or both. The analysis of their respective succession and gift duty systems is subdivided into four main divisions so as to facilitate comparison between the different countries. After a brief description of the different forms of succession and gift duties and the tax liability, the determination, valuation and computation of these taxes is considered. An enumeration of the main exemptions and deductions then follows, as well as the calculation method and the rates. All of these points are important as they can result in wide differences amongst the countries which were considered.

A third part of the study consists of an attempt to raise a few points that are of importance when one considers the impact and significance of the different succession duty systems. It can be seen that the succession duties represent only a very small part of the fiscal receipts of these nations. Tax avoidance and evasion result in significant differences between the theoretical and the real tax burden of succession duties. *Like all taxes, succession duties have to be viewed within the overall fiscal system of a country.* Particularly significant in this respect, because of their close relationship, are the *net wealth taxes* that exist in some of the countries that are discussed. In order to place the succession duties within the tax harmonization plans of the European Economic Community, some of these appraisals are commented upon.

No claim can be made about the originality or the completeness of this report. Most of this work was, by necessity, based on indirect sources since it was impossible to consult the original European sources. Extensive use was made of the excellent summary in "European Taxation", "Statistiques et Études Financières", and the Harvard World Tax Series compilations.

This survey benefited greatly from preliminary consultations with Professor D. G. Hartle, Mr. R. Robertson of the Canadian Tax Foundation and Mr. F. W. Hurst of the Ontario Committee on Taxation. A discussion of a first draft with Mr. W. H. Cranston, Chairman of the Ontario Economic Council and Mr. H. I. Macdonald, Chief Economist of the Department of Economics and Development was extremely useful. I would also like to express my appreciation for the material help received from Messrs. Cranston and Macdonald, and the valuable assistance provided by Miss Francine Van Den Bulcke, assistant at the University of Ghent, who acted as my European-based correspondent.

I would finally like to apologize for the lack of fluency in the English language which will make this survey less readable.

— D. Van Den Bulke

[1] This remark made by C. Lowell Harris in his Survey on "Public Finance" (A Survey of Contemporary Economics, Homewood 1952), applied to the then prevailing American attitudes.

IMPACT AND SIGNIFICANCE OF DIFFERENT SUCCESSION DUTY SYSTEMS — A SUMMARY

A. *Quantitative Importance of Succession Duties in Europe*

The general purpose of the succession or estate duties in Europe seems to be social, as they try to prevent the conservation of large fortunes by restricting the possibility of transfer. Inheritance taxes are largely seen as an instrument to diminish inequality or to achieve re-distribution of income.

That the succession and gift duties do not have a pure fiscal purpose can be seen quite readily from the very small part of the total public revenue which flows from this source. This is clearly illustrated by the figures from Table XII tabulated by Kirschen and associates.

Apart from England, the government receipts from death and gift taxes never exceed 1.5%, and reach an extraordinary low for Germany with 0.1%. As the "other taxes" include some taxes on capital, however, one cannot take the German figure at face value. As will be mentioned below, the German tax on net wealth ("Vermogensteuer") should also be taken into account. Where the German death duty ("Erbschaftsteuer") brought in about DM 140 million or 0.2% of the total 1959 tax income of the Federal Government (social contributions excluded), the net wealth tax or "Vermogensteuer" amounted to DM 1.1 billion for the same year.

B. *Theoretical Tax Burden of the Succession Duties in Europe*

It has been noticed in the discussion of the separate countries that the duties differ very widely among the different countries. The general level of the tax is quite high in countries like Italy and Norway and on the lower side for countries like Luxemburg and Germany. The rates were also quite high in France until 1959. A law of December 28, 1959, changed the method of calculation and lowered the rates in order to allow for a better

TABLE XII*

Total Government Revenue (Current and Capital)
divided by taxation sources (1959 figures)
(in % of total)

	Belgium	France	Germany	Italy	Luxemb.	Netherl.	Norway	U.K.
Direct Taxes	31.0	20.0	34.0	18.7	36.7	39.9	42.5	49.1
Paid by households	(23.1)	(9.2)	(25.0)	(n.a)	(24.0)	(29.9)	(26.6)	(35.7)
Paid by unincorporated enterprises	(7.9)	(3.2)	(0.9)	(n.a)	(12.7)		(7.9)	
Paid by corporate enterprises		(7.6)	(8.1)	(n.a)		(10.0)	(8.0)	(13.4)
Indirect Taxes	39.0	48.3	30.5	43.0	33.1	30.6	42.2	35.2
Social security contributions	26.2	28.8	31.2	27.0	29.9	26.1	14.6	12.7
Succession duties	1.2	0.7	0.1	0.7	0.5	1.1	0.3	3.0
Other taxes	2.5	2.1	4.2	10.6	—	2.4	0.5	—
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*(Editor's note) the data in the table above for Succession Duties are those used in Chart I of Section 1 of the report.

conservation of the estate when inherited in the direct line.

Some of the most striking features are the differences between the English and the Continental systems. Where the United Kingdom only has an estate duty (levied on the total value) and no gift duty at all, the other countries put their succession duties (levied on the part received by each beneficiary) and gift duties on the same level.

Countries like Belgium and the Netherlands make an explicit distinction between a resident and a non-resident by distinguishing a succession and a transfer duty. In all countries, however, in establishing the definition of what property is taxable, the situs of the taxable property and the definition of a resident are important facts to be kept in mind when comparing the national systems. The only criterion in Italy is the location of the movable or immovable property on Italian territory; Germany enumerates all these variables in its "Valuation Law". While the Netherlands consider a person as a resident as long as he did not leave their country for more than 10 years, Austria defines a non-resident as someone who left the country for more than two years. One is considered a German resident as soon as one stays in Germany for more than six months.

The estate tax is very progressive in the United Kingdom and hardly progressive in the Netherlands where it is more of the proportional type. Except for the United Kingdom, where the progressive rates are only a function of the value of the estate, all the tax inheritance systems of the other countries are progressive in the function of the amount received and of the degree of relationship between the decedent and the inheritor. Important consequences can result from this. It will be sufficient to recall that in Luxemburg the children of the deceased do not pay tax at all and that the succession duty in France increases abruptly for an inheritance between brothers and sisters. As a succession between brothers and sisters is very often the continuation of a succession from the parents, this puts an additional burden on the estate. If the brother or sister who dies had not existed the inheritance from the parents would have come directly to the new beneficiary and would have been taxed at 15% only instead of 40%.

The most often quoted comparison to illustrate the inheritance taxation system differentials is Table XIII below.*

TABLE XIII

Succession and Gift Taxes Payable
on Estate of $2,800,000 or £1,000,000

Country	%
France	28.00
Germany	10.00
Italy	61.50
Holland	18.50
Belgium	14.00
U.K.	75.00

—from "European Fiscal Systems" (Northcliffe).

Assuming an estate of $2,800,000, of which 40% passes to the widow, 15% to each of the three sons or daughters and 5% each to three brothers and sisters, the percentage duties which will have to be paid are the highest in the United Kingdom and in Italy. The rates are only about half of this in France, while Holland, Belgium and Germany have still lower rates for this particular case. Luxemburg levies even smaller duties than that.

Another illustration of the different rates of death duties was given by Kirschen in his "Economic Policy in Our Time", (Vol. 1) which is shown here in Table XIV.

* (Editor's note) these data are reproduced in Chart IV of Section 1 of the report.

TABLE XIV*

Death Duties in 1959

(in percentage of total sum liable to tax)

	Belguim	France	Germ -any	Italy	Luxem -bourg	Holland	Norway	U.K.
Case A								
$ 10,000	2.6	0	3.5	5.9	0	9.0	7.8	0
20,000	3.1	0	4.5	9.2	0	11.0	13.3	0
50,000	4.1	6.0	5.5	16.5	0	13.0	21.8	0
100,000	5.4	10.5	6.5	22.8	0	15.0	28.4	4.8
1,000,000	12.8	14.6	11.0	40.9	0	17.0	34.4	33.0
Case B								
$ 10,000	17.5	60.0	20.0	22.8	21.0	46.0	16.8	1.0
20,000	18.8	60.0	24.0	38.6	24.0	48.0	22.4	3.0
50,000	23.1	60.0	28.0	52.2	28.5	50.0	33.5	12.0
100,000	28.8	60.0	32.0	60.9	34.6	52.0	41.8	24.0
1,000,000	60.8	60.0	48.0	83.0	48.0	54.0	49.2	65.0

A represents the case when the inheritor is the only son of the deceased, while B shows the case when the inheritor is a stranger or a non-relative to the decedent.

The significance of the computations given in Table XIII and Table XIV is not too great, however. Avoidance of succession duties is so great that one cannot take the nominal rates as indicative of the burdens of the tax. It can, therefore, be stated that the actual revenues, as quoted in Table XII, are probably a better measure. Although this confirms that the U.K. has the heaviest death taxes, the scale of classification is not the same for the other countries.

C. *Real Tax Burden of the Succession Duties*

It is, of course, clear that for the comparative calculation of inheritance taxes, the numerous exemptions and deductions have to be taken into consideration. As a consequence, the theoretical rates can be quite different from the real rates that have to be paid.

The contradiction between the high succession and gift duties and the small share of total government revenues shows that there must be a lot of loopholes to the succession duty laws. The Economist, for example, noted that although the U.K. rates are very high, the duties that have been collected are not much higher than they were 10 years ago. This is surprising in view of the tremendous rise in property values and stock exchange prices over this decade.

Taking an annual increase of 3% for profits (which assumes that the inflatory trend in prices experienced since the war has been eliminated) as his basis, and allowing the average holding of an inheritance to be 30 years, Tait has argued that the capital value can be increased by 2.4. This is more than doubled by simply allowing for the passage of time. This would mean that the estate can be doubled in value during the normal lifetime of the owner of an estate. From this Tait concludes that an estate which is not taxed at 50% stands a very good chance of maintaining or even increasing its size, thus not achieving any re-distribution purpose.

One has little evidence to estimate the impact of inheritance and gift taxation and the main methods of tax avoidance in each of the countries discussed. Each legislation offers, first of all, scope for minimizing the taxes in many ways which are very often dependent upon the wording of the law in question. This means that comparisons of the real impact of the rates have, in fact, very little significance.

Carl Shoup has drawn up a list of the major

* (Editor's note) these data are reproduced in Charts II and III of Section 1 of the report.

loopholes frequently used to avoid the high British estate rates. It is clear that the largest loophole is offered by the provision that gifts transferred 5 years before the death cannot be taxed.

An ingenious device is the interpretation of a law article that states: if a tenant makes improvements to the land, with the owner's written consent, he must be compensated for the remaining value of the improvements when he leaves the land either through expiry of the lease or because of his death. The device then consists of an inter vivos gift of land from the father to the son for example, while at the same time founding a company that leases the land back from the son. If the company then invests to improve the land without on purpose asking the consent of the new owner, the son will not be taxed at the time of his father's death on the improvements that have taken place since the scheme was developed. It is thus possible to transfer an estate to a future inheritor with the intention to limit the estate taxes, while keeping control on the estate through the company.

Until 1957 it was possible to escape the duties by transferring securities of a very short term, provided that the donor lived until the securities matured in the hands of the donee, even if he died within 5 years of the time of the gift. As the donee was able to convert the securities into cash, the property had disappeared and there was no taxable basis any more.

As agricultural property pays only 55% of the full tax rates of the estate duty, agricultural land purchases are quite common to avoid the high duties and avoid breaking up the estate.

The proceeds of a life insurance policy also allows an important loophole, as a life insurance policy is treated as a separate estate if the policy falls within the class of properties in which the deceased never had at any time any beneficial interest. The life insurance companies agreed under government pressure to limit the "insurance trusts" that can be concluded.

Another possibility is offered by the "discretionary trusts" which allows avoidance of the death duty upon death of the beneficiary by deferring expiry for two or more generations. The donor places property in trust which can be paid to several stages of descendents, at the discretion of the trustee, who can be the donor himself or someone appointed by him. If a son of the trustee dies, no duty will be levied if the grandson has also been placed upon the list, since no property is deemed to pass. Only upon the death of the "last-but-one" does the death duty take effect.

Shoup also mentions the "strip trick". Shares of stock that are passed by gift inter vivos and are caught in estate duty because the donor dies within 5 years are included at their value at the time of the donor's death and not as of the date of gift. When shares have been transferred to the donee and the donor dies within the 5 year period, the shareholders of which the donor is not a member any more can transfer these to shares already held by the donee for more than 5 years, thereby diminishing the taxable value.

Although the above examples are taken from a British context, there is no reason to suppose that they are typical only of the United Kingdom. On the contrary, the negligible tax receipts from succession duties in the other European countries indicate that there are perhaps more loopholes on the continent. What is certain is that the continental (especially Belgium, France and Italy) mentality results in higher tax evasion practices than in the United Kingdom.

No studies have tried to compare the extent to which people purchase an annuity on which they then live; or emigrate to a tax haven; or create a settlement in which the settler is not beneficially interested but which will benefit his spouse, descendants are relations; or the setting up of a family company or close corporation to which the person wishing to avoid tax transfers a substantial part of his assets in exchange for shares or debentures, other shares being held by members of his family or by trustees on their behalf. It is also very difficult to judge to what extent some of the above escape possibilities do fall or do not fall under particular law paragraphs.

D. *Succession Duties and Net Wealth Taxes*

Succession duties cannot be viewed in isolation. One should especially pay attention to the system of property taxation that is applied in the country in question. As we have seen, countries like Belgium, France, Great Britain . . . make use of occasional taxes which are only payable when there

is a change of ownership. Other countries also levy a sort of periodic tax which has to be paid by the owner at regular, mostly yearly, intervals. This is done, e.g. in West Germany, Holland, Luxemburg, Austria, and Sweden.

For purposes of international comparison it is important to be aware of the countries that levy a net wealth tax. In Germany the Vermogensteuer is payable by resident individuals and corporations on all capital assets, i.e. movable and immovable, both in and outside Germany. Non-residents, however, are only liable on certain specified assets wirth more than DM 2,000, e.g. a permanent establishment in Germany is taxable. The individual taxpayer gets a number of allowances, while companies can get a deduction for a holding in another German company of 25% or more. The nominal rate is 1%, although some older property only pays 0.75%. In Luxemburg and Austria the net wealth taxes are similar to the German system, but the rate of tax is 0.5%.

The Dutch net wealth tax is only imposed on natural persons and is levied on all the net assets owned by the residents in Holland and abroad. The non-residents are only taxed on certain specified assets in the Netherlands. Tax free allowances exist. The general rate is 0.5%.

Mention should be made of the Italian "Imposta sulla Societa" which taxes 0.82% of the capital and reserves of companies. This is both a property and a profits tax and is levied at 15% on the portion of profit which exceeds 6% of net worth and 0.75% on the net worth itself.

TABLE XV
Succession Duties and Related Duties
in European Countries

	Estate Tax	Succession Duty	Gift Tax	Net Wealth Tax
Belgium		*	*	
Netherlands		*	*	*
Germany		*	*	*
France		*	*	
Italy	*	*	*	(1)
Luxemburg	*	*	*	*
United Kingdom	*			
Sweden		*	*	*

[1] Italy has the "Imposta sulla Societa" however (see above).

Table XV presents a review of the different taxes that have to be taken into account when judging the succession duty systems of a number of countries. For this classification the distinction between a succession and transfer tax, as it exists in Belgium and Holland, is not made. Both concepts are covered by succession duty.

E. *Appreciation of the Economic Effects of Succession Duties*

The question of which taxes to harmonize, if one pretends to erase the national tax frontiers in an attempt to achieve economic integration, came to the forefront with the establishment of the European Economic Community.

It has generally been agreed that an indispensable prerequisite for fiscal harmonization is the equalization of the imposition system and rates of both the turnover tax and the taxes on the production of certain products (excise duties). Differences can eventually be allowed to exist if enough uniformity is reached for the corporation tax, and the real income taxes. If the systems and the rates are different but the fiscal burden is quite similar, taxes on the wealth of the individuals and personal taxes on the total income can be left unchanged. It is often judged that the harmonization of consumption taxes at the retailer's stage, real property tax and succession duties have slight chance of leading to distortions and should not therefore be equalized. A prominent defender of this view is Professor Cosciani of the University of Rome.

It is a fact, that the Common Market Treaty says little about the harmonization of direct taxes in general (it does so for indirect taxes) and does not expressly call for harmonization of national legislation in the articles devoted to this (cf. articles 95 to 99). Articles 100 to 102, which deal with the adaption of national legislation in general and not only with taxation, are very broad in scope, however, and therefore also apply to fiscal problems. Article 100 stipulates that harmonization is necessary for "laws and administrative decisions of the member countries which have a direct incidence on the establishment or functioning

of the common market. Lelux, EEC Director, thought that the incidence was important for the taxation of the profits of enterprises and equalization should be negotiated, but the taxes on land, income tax paid by natural persons, death duties, etc. . . . have no coincidence and can be excluded from an harmonization program.

The Annual Report of the Federation of Belgian Industries in 1964, which has a special chapter on the Reform of Belgian Fiscality in view of the Common Market tax harmonization, makes no mention of succession duties. Detinger, discussing the Dutch system of death and property taxes, states that succession duties are, "both owing to structure and owing to height of rates, also from an angle of internationally similar competitive conditions for industrial production, no factors of importance."

Yet, the Neumark-Report (Report of the Fiscal and Financial Committee on Tax Harmonization in the Common Market) in a brief paragraph points out that inheritance taxes "are nevertheless often, at least where large inheritances or large estates are involved — *so high that flagrant differences between countries can lead to transfers of domicile and of capital attributable to fiscal reasons.*" The expert report goes on by arguing that this concerns less the types and forms of inheritance taxes than their amount and concludes that "in the interest of the greatest possible "tax transparency" it would also be desirable to have a certain formal approximation of the inheritance tax systems (either of the tax on inheritance or of the estate tax, or else a certain combination of both)." This view is, however, not too different from the above statements as it stresses harmonization not so much for reasons of eliminating distortions but only for increasing the "transparency" of an overall system.

As a matter of fact, the succession duties are the only taxes on property and wealth where a relative uniformity exists. Allowing for differences, *the absolute maxima are high everywhere in Europe, 80% in Italy, 72.6% in Belgium, 60% in West Germany and France, 54% in Holland, while the minima for small average estates, inherited in the direct line, are rather low in all the E.E.C. countries.* For children the maxima are 15% in Germany and France, 15.4% in Belgium, 14% in Holland; Italy is once again the exception as 35% is levied on inheritances by children.

These differences might indeed be important for large estates. But, the many loopholes and tax avoidances are especially resorted to by the large estates in all of the countries discussed above.

THE SYSTEM OF SUCCESSION AND GIFT DUTIES IN THE COMMON MARKET COUNTRIES

BELGIUM

1. *Summary — Types of Tax and Tax Liability*

The Belgian law makes a difference between the succession duty and the transfer duty. The *succession duty* ("droit de succession") is levied when a resident who dies leaves taxable property to another person, who can be either a resident or a non-resident. The *transfer duty* ("droit de mutation par deces") on the other hand, is due when a non-resident dies and leaves real property situated in Belgium to another person, who can be a resident or a non-resident.

Apart from these two death duties, a *gift duty* ("droit de donation") is levied at the same rates. The gift duty is a registration duty levied on transfers of property for which no payment is demanded. As the law only requires registration for transfers of real property which is located in Belgium, real property outside Belgium is exempt from this duty. If personal property which is located in Belgium is transferred, the registration is only due when the donation took place by a written document. If the personal gift is not recorded in a written document, no gift duty has to be paid.

2. *Determination, Valuation, and Computation of the Tax*

If the decedent is a resident of Belgium, the succession duty is levied on the value of all property (whether real or personal, tangible or intangible, situated within or outside Belgium) which passes at the death of the owner.

If the decedent is a non-resident, the transfer duty is only imposed on the value of real estate situated in Belgium.

The gift duty is levied on the value of real property situated within Belgium and all personal property situated within or outside Belgium which is donated through a written instrument and submitted for official registration.

For *the computation* of the succession duty one takes the values of the property received by each beneficiary and not the estate as previously owned by the decedent. All debts linked to the property are deducted from the taxable sum if they existed on the day of the death. Funeral costs can also be deducted. Debts concluded by the decedent to the advantage of an inheritor or beneficiary are not accepted, unless their authenticity is proven or unless their purpose is the protection of the goods that were still the property of the testator before his death. (It is therefore the net value which is levied upon).

The value of the property acquired is the market value at the time of death. It is traditional to estimate the unreal values of a business (e.g. goodwill etc.) at up to three times the average net income realized by the firm in the preceding year.

Both the transfer duty and the gift duty are also levied on the market value. The transfer duty is due on all real property that passes at the time of death, while the gift duty is due on what each beneficiary receives and not on the total amount if there are several beneficiaries. The debts are not deductible in either of these cases.

3. *Exemptions and Deductions*

No exemptions are granted for the transfer and gift duty. An exception is made for the transfer duty if this has been provided for in an international treaty.[1]

For the succession duty an exemption of B. frs. 100,000 (= $2,000) is granted from the total taxable amount received, if the beneficiary is a direct ascendent or descendent (e.g. parent or child) or a spouse having at least one child born in wedlock.[2] If the beneficiary is a minor

TABLE XVI

Rates of succession, transfer and gift duties in Belgium (in %)
(Law of February 14, 1961)

Value of net estate (in Belgian Francs) From	To	Direct line of ascendents and dependents Spouse having at least 1 child born in wedlock	Spouse with no children born in wedlock	Between brothers and sisters	Aunts, uncles, nieces and nephews	non-relatives
$ 1	$ 20,000	1.4%	6.6%	12.1%	14.3%	19.3%
20,001	40,000	1.7	6.6	12.1	14.3	19.3
50,001	100,000	2.2	6.6	12.1	14.3	19.3
100,001	200,000	2.8	6.6	12.1	14.3	19.3
200,001	500,000	3.3	7.7	12.2	14.3	19.3
500,001	1,000,000	3.9	8.8	14.3	17.1	22.0
1,000,001	2,000,000	5.0	11.0	19.3	22.0	27.0
2,000,001	3,000,000	6.1	13.2	24.4	27.0	31.9
3,000,001	4,000,000	7.2	15.4	29.2	31.9	36.9
4,000,001	5,000,000	8.3	17.6	34.1	36.9	41.8
5,000,001	6,000,000	9.4	19.8	39.1	41.8	46.8
6,000,001	7,000,000	10.5	22.0	44.0	46.8	51.7
7,000,001	8,000,000	11.6	24.2	49.0	51.7	56.7
8,000,001	9,000,000	12.7	26.4	53.9	56.7	61.6
9,000,001	10,000,000	13.8	28.6	58.9	61.6	66.6
over 10,000,000		15.4	30.3	63.8	67.1	72.6

[1] For a list of the tax treaties see Appendix III.

[2] This amounts to a reduction in taxes of B. frs. 1,890 or something less than $40.00.

(i.e., less than 21 years of age), an additional amount of B. frs. 20,000 (= $411) may be deducted for each year before reaching majority. If the beneficiary is a spouse with minor children, an additional amount of B. frs. 10,000 (= $200) may be deducted per year for the remaining years before each child reaches majority.

Completely exempt are the inheritances received by each beneficiary, when they do not exceed B. frs. 7,000 (= $140).

A deduction of 2% of the total tax amount is granted for each child of the beneficiary in case of the succession, transfer or gift duty. This amount is increased to 4% if the beneficiary is the spouse of the decedent.

It should also be mentioned that if the beneficiary receives real property located outside Belgium, any foreign death duties levied may be deducted from the Belgian succession duty computed on the value of the real property. The gift tax can be reduced by 50% if an ascendent (e.g. parent) makes a gift to a descendent, (e.g. child) in contemplation of marriage.

4. *Rates and Calculation Method*

The progressive rate system applies to the succession, transfer and gift duty. The rates depend on the amount one inherits, the degree of family relationship between the decedent or donor and the beneficiary and the number of children of the beneficiary. The age of the children has only importance for the exemptions that this allows for.

THE NETHERLANDS

1. *Summary — Types of Taxes and Tax Liability*

Under the Succession Law of 1956, the acquisition of property through death and donation in the Netherlands is subject to three tax impositions . . . the succession duty, the transfer duty and the gift duty. The similarity to the Belgian system is not too surprising if one takes into account the common heritage of these countries before 1830.

The *succession duty* is levied on the value of everything which is acquired from a decedent who resided in the Netherlands. The *gift duty* is levied on what is received from a donor who is resident in the Netherlands. When the decedent or donor is a non-resident neither succession or gift tax applies; instead a *transfer duty* is imposed on certain types of property located in the Netherlands.[1]

The imposition of succession duty and gift duty, though in principle governed by the place of residence, takes place to a limited extent according to the principle of nationality. A Dutch donor or decedent who had his residence in the Netherlands and who has made a donation or dies within 10 years from his leaving the Netherlands, is considered to reside in the Netherlands at the time of the donation or at the time of his death. The succession and gift duties are levied accordingly. A transfer duty will only apply if the Dutchman resided for more than 10 years in a foreign country.

As we have seen, the domicile, residence or nationality does not in principle affect *liability* to the tax. Each beneficiary is, at the tax inspector's discretion, liable for either the succession duty on his part of the inheritance, or that part of the total succession duty which bears the same ratio to this total succession duty as the beneficiary's part of the inheritance bears to the total estate. In addition to this, each of the resident beneficiaries is jointly and severally liable for the total tax due by the non-resident beneficiaries. Similar provisions are stipulated for the transfer duty where resident beneficiaries are responsible for the payment of the total amount of transfer duty, and the gift duty where the donor and the donee are jointly and severally responsible for payment of the tax.

2. *Determination, Valuation and Computation*

The succession and gift duties are levied upon *the value* of all of the property which passes or is donated, irrespective of its location within or out-

[1] These are real property located in the Netherlands, or, loans secured by mortgages on Dutch real property, or, moveable property used in a Dutch business or profession, or a silent partner's interest in a business with its registered office in the Netherlands, or, a right to profits from a Netherlands business with its registered office in the Netherlands (except stock in a Dutch Corporation).

side the Netherlands. The transfer duty is levied on the value of the types of property of Dutch situs as listed in the above footnote 1 on the previous page.

As regards *the basis* of the succession duty, the tax is in principle imposed on the value of what each individual beneficiary acquires under statutory right of succession or under the last will in the form of a heritage, legacy or benefit under disposal by will. The Dutch succession duty is not, therefore, a taxation of the estate as a whole, but a tax on what any one entitled to the estate individually acquires. Business goodwill is also considered an object of taxation. Donations, within 180 days prior to the donor's death and what is acquired as a result of or after the death of an individual under a life assurance agreement or under a stipulation on behalf of a third party, also fall under the succession acquisitions. The deceased's debts (recoverable by law, in so far as encumbering the acquisition), are deducted from the residue of what has been acquired under right of succession. The funeral expenses are also deductible.

The gift duty is levied on the amount received by each individual donee. Gifts are taken into account on a two years' basis, i.e. if in two successive years gifts are made to the same person, the amounts donated are added up. As the rates are progressive, this has an important effect on the amount to be paid. Gifts made by parents to their children are only taxed on a per year basis, however.

The only two kinds of liability which are not considered for the transfer duty are the debts secured by mortgages on the received Dutch property, and debts directly referring to the Dutch business or the interests in Dutch silent partnerships.

3. *Exemptions and Deductions*

The exemptions to the succession duty are especially numerous in the case of acquisitions within the circle of members of the family and that of the next of kin. The widow is allowed an exemption of Dutch florins 20,000, plus D. fl. 750 for any one year the children are younger than 21 years. For a widower the allowed exemption is D. fl. 10,000 while the exemption for the minor children is the same. For relations in the direct line there is an exemption of D. fl. 3,000, which is increased for children or parents of the testator who are over 60 years old or invalid. For minor children the D. fl. 3,000 exemption is increased by D. fl. 750 for every one year the child is younger than 21 years, with the proviso that for a minor invalid child the exemption shall be at least D. fl. 5,000. There is also, for the support of widows and orphans, a separate exemption for the capital value of periodical payments up to a maximum of D. fl. 4,000 per annum, acquired under a life insurance or a third-party stipulation (private pensions resulting from a working agreement). This exemption, however, reduces the above-mentioned capital exemption of D. fl. by a sum of I fl. 17,000 as a maximum.

The principal exemption to the gift duty is that no duty is levied when the donations made by a donor to one and the same donee within a period of two years are lower than a total of D. fl. 2,000. When the beneficiaries are children the amount of D. fl. 2,000 can be donated free from duty in only one calendar year. If the gift is made in the year of the child's marriage, the exemption amounts to D. fl. 10,000 as a maximum.

No exemptions are allowed for the transfer duty. The same rates also apply for direct descendents and ascendents.

Deductions from succession duty can only take place when the inheritor receives property from his parents or spouse and when he has four or more minor children, or children up to 27 years if they are still being educated. For this case the duty is decreased by 10% for the fourth child and each subsequent child with a maximum reduction of 50% of the duty or D. fl. 1,000 whichever is less. This deduction is not accepted for the gift or transfer duty.

4. *Calculation Method and Rates*

The rates of the succession and gift taxes are the same. The tariffs operate in a special proportional way. On the one hand they vary according to the value of what is acquired; on the other hand the percentage of duty imposed increases according to the remoteness of the relationship between testator or donor and beneficiary. These rates can be read from Table XVII.

The rates for the transfer duty are different from the succession and gift duty, as it is levied on a proportional rate of 6%, with no relief on account of children.

TABLE XVII
Rates of Succession and Gift Duties in the Netherlands
(Succession Duty Law of 1956)

Value of Property (in Dutch florins) From	To	Children and spouse		Direct line of descendents		Direct line of ascendents		Brothers and sisters		Children of brothers and sisters		All other persons	
(a)	(b)	(c)	(d)	(c)	(d)	(c)	(d)	(c)	(d)	(c)	(d)	(c)	(d)
1	1,000	0	3	0	5	0	10	0	18	0	27	0	36
1,001	2,000	30	4	50	6	100	12	180	20	270	29	360	38
2,001	5,000	70	5	110	8	220	14	380	22	560	31	740	40
5,001	10,000	220	6	350	10	640	16	1,040	24	1,490	33	1,940	42
10,001	25,000	520	7	850	12	1,440	18	2,240	26	3,140	35	4,040	44
25,001	50,000	1,570	9	2,650	14	4,140	20	6,140	28	8,390	37	10,640	46
50,001	100,000	3,820	10	6,150	16	9,140	22	13,140	30	17,640	39	22,140	48
100,001	200,000	9,320	11	14,150	18	20,140	24	28,140	32	37,140	41	46,140	50
200,001	500,000	22,320	15	32,150	20	44,140	26	60,140	34	78,140	43	96,140	52
500,001	and more	67,320	17	92,150	22	122,140	28	162,140	36	207,140	45	252,140	54

(c) tax amount in D. fl. on an inheritance of a value as given under (a)
(d) percentage that is levied on the value of the property in excess of (a)
e.g.—A person inherits D. fl. 40,000 from his father. The death duties will be D. fl. 1,570 on D. fl. 25,000 and a 9% inheritance rate on the remaining D. fl. 15,000, which is D. fl. 1,350, or a total duty of D. fl. 2,920.

GERMANY

1. *Summary — Types of Tax and Tax Liability*

Germany levies an *inheritance and gift tax* imposed on the gratuitous transfer of property either by reason of death or inter vivos. The statutory basis of the tax is the Inheritance Tax Law ("Erbschaft Steuergesetz") which distinguishes between residents and non-residents for its method of taxation.[1]

The duty will be levied when the decedent or doner was a resident at the time of his death, whether the property is situated in Germany or abroad, and whether the beneficiaries or donees are residents or non-residents. The duties will also have to be paid when the beneficiary or donee is a resident at the time when his liability for the tax originates even if the decedent or donor was a non-resident at the time of his death, but the tax is imposed only on transfers of domestic property. In summary, a transfer of domestic property is always taxable, even when transferred from a non-resident to a non-resident, while a transfer of foreign property is taxable if either the decendent (donor) or the beneficiary (donee) is a resident on the effective date.

[1] Individuals are considered a resident of Germany if they have their domicile or long term place of abode in Germany. As soon as an individual stays in Germany for 6 months, he is deemed a resident as of the date of entry. A legal entity is deemed to be resident if it has its seat or management in Germany.

The primary *liability* for the payment of the tax rests upon the recipient of a share of the decedent's estate. Several recipients are jointly and severally liable for the payment of the tax. By agreement, this liability may be shifted to another, e.g. the donor, but if he fails the recipient can always be asked to pay. The property passed may be attached for payment of the duty, if possible, as well as other property of the recipient if it can be reached. Where the donor agrees to pay the gift duty, this increases the taxable basis.

2. *Determination, Valuation and Computation of the Tax*

If the transferor, transferee or both are residents of Germany, property wherever situated will be taxed for the total if the transferor is a resident and for the part received if the transferee is a resident.

As has been mentioned already, if none of the parties are resident in Germany, only property situated in Germany will be taxed. The types of property situated or deemed to be situated in Germany are enumerated in the "Valuation Law" and include:

(a) property which is appropriated to the use of a domestic agricultural establishment.
(b) real property situated in Germany;
(c) property appropriated to the use of a business which is operated in Germany through a permanent establishment located there;
(d) patents, copyrights, and other intangible rights, not included under item (c) above which are utilized for business purposes and in a German public book or register;
(e) assets other than those listed under items (a), (b) and (d) which are rented or otherwise made available to a business establishment located in Germany;
(f) mortgages, other encumbrances or real property, and debts and rights including annuities which are secured directly or indirectly by German real property, or rights in the nature of real property which have a situs in Germany or ships which are registered in Germany; and
(g) the rights of a non-resident silent partner in a resident business.

As a consequence of this enumeration it appears that, if neither the transferer nor the transferee is a resident in Germany, no death or gift duty can be levied on:

(a) bank accounts, saving accounts and similar deposits, provided that they do not form part of the assets of a domestic business, agricultural or professional establishment;
(b) accounts receivable or other debts owned by a resident debtor, or bonds issued by a German company, provided that the debt does not form part of the assets of a domestic establishment of the creditor;
(c) shares of a resident corporation, irrespective where they are situated, ownership interest in a resident limited liability company (G.m.b.h. gesellschaft mit beschzankter haftung) or other membership rights in a resident company, except for the membership right of a co-entrepreneur, such as a partnership share in a resident partnership. This rule applies even if the entire capital of the resident company is owned by a non-resident (substantial holding), and it also applies if the assets of the company consist exclusively or predominantly of real property situated in Germany; and
(d) the capitalized value of annuities and other recurrent payments of benefits, if the right of the creditor is not secured by real property situated in Germany or rights in the nature of immovable property which have their situs in Germany.

The determination of the value of the taxable property takes place according to the Valuation Law. The main provisions are that property situated outside Germany is valued at its fair market value ("gemeinerwert"), while property located inside Germany has different valuations according to its nature. Real property is valued at its standard value ("Einheitswert") as last determined to the date of transfer. This standard value is reviewed regularly for business enterprises. In 1960 the standard value of agricultural and forestry enterprises was still determined at the "Einheitswert" of 1935. Shares are valued according to periodical lists, published by the tax authorities. Other property is taxed at

market value ("Gemeinerwert") if not used for business purposes. If used in business, valuation takes place at going concern value ("Teilwert").

3. *Exemptions and Deductions*

Transfers of household property of the donor or decendent to the spouse or children are exempt insfar as the value of the property does not exceed DM 20,000. If such property is transferred to other relatives, the first DM 5,000 is exempt. Jewelry and luxury items are exempt up to DM 5,000 in value if transferred to the spouse or children, and up to DM 2,000 if transferred to other relatives. The exemptions do not apply to money or other media of payment, precious metals or stones, or property which forms part of an agricultural or business establishment.

Art objects and collections which are transferred in the lineal line by gift or inheritance are exempt within certain limits unless they are business property. Art objects by German artists who either are alive or deceased not more than 15 years are exempt irrespective of value. Other art objects and collections are exempt if their total value (combined with the value of objects created by German artists) does not exceed DM 20,000. If this limit is exceeded, the entire transfer is taxable.

Transfers for public, religious or charitable purposes are exempt without limitation. Also exempt are transfers of property of public interest if they were owned by the same family for at least 20 years and agreed to be held for more than 10 years by the transferee. A further exemption covers usual and occasional gifts (customary within the group to which the donor and donee belong and for the occasion at which it is made), gifts for support or education of students or dependent children and certain gifts to descendents (e.g. gift of money or property made to enable the donee to set up a household). Pensions and similar benefits granted to present or former employees of the donor or decedent are exempt if there is no legal obligation to make the payments. The same applies to transfers to pension funds or welfare funds established for the transferor's business.

Apart from the general expenses which are directly related to the property and which are deductible from the total estate, such as funeral and administrative costs, there are a number of personal exemptions.

If the transferor or the transferee or both are residents in Germany the following deductions are allowed. The spouse of the transferor is not taxed on the first DM 250,000 in value of the taxable property transferred, if children or other descendents from the transferee's marriage with the transferor are living at the time when the liability for the tax originates. If there are no children, or other descendents, the personal exemption of the surviving spouse is limited to DM 30,000. Transfers to the children of the transferor are also exempt up to DM 30,000, while transfers to the descendents of

TABLE XVIII

Rates of Inheritance and Gift Taxes in Germany (in percentage) (law of April 1, 1959)

Total value not over DM . . .	Class I	II	III	IV	V
10,000	2	4	6	8	14
20,000	2.5	5	7.5	10	16
30,000	3	6	9	12	18
40,000	3.5	7	10.5	14	20
50,000	4	8	12	16	22
100,000	4.5	9	13.5	18	24
150,000	5	10	15	20	26
200,000	5.5	11	16.5	22	28
300,000	6	12	18	24	30
400,000	6.5	13	19.5	26	32
500,000	7	14	21	28	34
600,000	7.5	15	22.5	30	36
700,000	8	16	24	32	38
800,000	8.5	17	25.5	34	40
900,000	9	18	27	36	42
1,000,000	9.5	19	28.5	38	44
2,000,000	10	20	30	40	46
4,000,000	11	21	32	42	48
6,000,000	12	22	34	44	51
8,000,000	13	23	36	46	54
10,000,000	14	24	38	48	57
over 10,000,000	15	25	40	50	60

If the value of the inherited or donated property falls between the two brackets it is taken at the rate which applies to the higher bracket. This provision is mitigated by the provision that the differential in tax between the two brackets may not exceed a certain portion of the amount in excess of the lower bracket. These portions are 50% if the rate is not more than 30%, 75% if not more than 50% and 90% if the rate is more than 50%.

the children are exempt up to DM 20,000 in value. Transfers to ascendents, brothers, and sisters (also in-laws) and nephews and nieces are exempt only if the value of the transfer does not exceed DM 3,000. When the beneficiaries of a transfer are not those enumerated above, there is only an exemption if the value of the transfer does not exceed DM 1,000. For the latter two cases the transfer which exceeds the DM 3,000 and DM 1,000 limits is fully taxable, but total tax payable may not be more than 50% higher than the amount of the transfer in excess of DM 3,000 and 1,000 respectively.

If both the transferor and the transferee are non-residents, the transfer is non-taxable only if the value does not exceed DM 1,000; it is fully taxable if its value exceeds that amount. Here again, the maximum tax payable may not exceed 50% of the amount of the transfer exceeding DM 1,000.

If spouses and children and other descendents inherit property which was acquired similarly by persons in the same category within the preceding 5 years and at that time subjected to inheritance tax, the tax is reduced by 50%. If the prior transfer occurred more than 5 years but not more than 10 years earlier, the tax is reduced to three-quarters.

4. *Rates and Method of Calculation*

The German rates are progressive according to the class to which the beneficiary or donee belongs and to the value of the property transferred. The law distinguishes five different classes. The persons who are included in each class are:

Class 1: The transferor's spouse and children, including stepchildren and adopted children (but not foster children).

Class 2: Descendents of the children listed in Class 1. Descedents of adopted children are included in this class if the effects of the adoption are extended to the descendents of the adopted child.

Class 3: Parents, including step-parents, grandparents, and more remote ancestors, and brothers and sisters.

Class 4: Sons-in-law, daughters-in-law, parents-in-law, and nephews and nieces.

Class 5: All other transferees. This class includes cousins and legal entities.

Table XVIII gives the schedule of the rates for both inheritance and gift taxes according to the individual classes.

5. *Foreign Tax Credit*

A foreign death or gift tax can be credited against the German inheritance law if either the decedent (donor) or the transferee is a German resident at the time of death or transfer. All foreign taxes which are directly occasioned by the death of an individual qualify for the credit regardless of their character or designation. A foreign gift tax is creditable if it is substantially similar to the German gift tax, the tax being imposed on the gratuitous transfer of property inter vivos.

The credit is available for foreign death duties imposed on property which is foreign. If the decedent was a resident at the time of his death, foreign property includes all property of the types listed under the Valuation Law (see above). If the decedent was a non-resident at the time of his death, foreign property includes the entire property of the decedent except those listed under the Valuation Law that are situated in Germany.

It follows from this that the foreign tax credit cannot be used to reduce the German inheritance tax on property which is domestic property according to the rules of the Valuation Law, even if this property is also subject to a foreign death tax. For such cases, there is no relief from double taxation, except if provided for in a Tax Treaty.

FRANCE

1. *Summary — Types of Tax and Tax Liability*

Under the French system death and gift duties are part of the registration duties which are levied on the official registration of all types of legal instruments. Death and gift duties are levied on transactions which do not take place for money or money's worth ("mutations à titre gratuit").

Unlike the Belgian and Dutch systems there are only two (not three) forms of death and gift duties. The *death duty* ("droit de mutation par deces") is due when a resident or a non-resident individual dies or a legal entity leaves property which is taxable. The *gift duty* ("droit de donation") is due when a resident or non-resident in-

dividual or legal entity voluntarily conveys to another taxable property.

The beneficiary is primarily liable for both the death and the gift taxes. The donor or his representatives may also be held responsible for the payment of the gift and death duties.

2. *Determination, Valuation and Computation*

As a general rule only property which is situated in France is taxable. Real property (e.g. land and buildings) tangible personal property (e.g. inventory, furniture) as well as intangible personal property (e.g. stocks and securities) are subject to both taxes. The principle of territoriality is extended to intangible property, even if not located in France, when the donor is in France or when the transfer is subject to French civil law.

The duty is computed on the basis of the value of the property transferred. For real property this is considered to be the real market value. For tangible personal property there is a distinction between the gift and the death duty: in the former case it is the real market value which counts, while in the latter case the value given by the notary is determining. For intangible personal property the value is determined by taking the market purchase price at the time of gift or death.

Certain costs are deductible from the total value of the estate before calculating the taxable basis in the hands of each of the recipients. Both for gift and death taxes, the taxable amount also includes gifts made by the same donor in previous years. A credit, however, is given for the gift-taxes already paid.

3. *Deductions and Exemptions*

Both for the death duty and the gift duty, certain deductions are allowed. Ascendents of the donor, his children and their representatives, as well as his spouse, may deduct the amount of NF (new francs) 100,000 from the total taxable amount each of the beneficiaries receives.

Additional deductions which are allowed are:

(a) Bonds "Pinay", which are State-loan bonds issued between 1952 and 1958 at 3½% interest rate;

(b) Dwellings completed since January 1, 1948;

(c) Lump sums received in the form of a life insurance; and

(d) Woods and forests up to three quarters of their value, on the condition that the inheritors exploit them normally for a period of 30 years.

Apart from this no deductions are allowed for inheritances or gifts in the collateral line or for non-relatives. Only for brothers and sisters is a deduction of NF 30,000 provided. The conditions under which this deduction can be used, are however, highly restrictive. The brother and sister beneficiaries have to be older than 50 years on the moment of death of the decedent brother or sister; they have to be incapable of providing their own subsistence and they have to have lived constantly with the decedent for a period of 5 years immediately preceding the latter's death.

4. *Rates and Method of Calculation*

The proportional rates for the death and gift duty on the value of the property transferred depend upon the degree of family relationship and the value of the amount received.

The rates for a transfer to a spouse or to all lineal (or direct) descendents are:

—5% for the first NF 50,000 of the taxable amount

—10% for the amount between NF 50,000 and NF 100,000

—15% for that amount above NF 100,000.

If the beneficiary has 3 or more children he may deduct from the tax amount up to NF 2,000 for each of the third or additional children.

The rates for a collateral or to a non-relative are:

—40% if the beneficiary is a brother or sister;

—50% if the beneficiary is another relative;

—60% if the beneficiary is not a relative.

If the beneficiary has 3 or more children he may deduct from the tax amount up to NF 1,000 for each of the third or additional children.

ITALY

1. *Summary — Types of Tax and Tax Liability*

Italy levies an estate, inheritance and gift tax. Both the *estate tax* ("imposta sul valore dell asse reditorio") and the *inheritance tax* ("imposta di successioni") are due on the death of a person who leaves taxable property located or deemed to be

located in Italy. Neither the nationality nor the residence of the decedent is a decisive criterion for liability to Italian death taxes.

The *gift tax* is due if an individual or legal entity transfers property by way of gift located or deemed to be located in Italy to another individual or entity. The taxes are due as soon as the gift is legally effected, which for personal property means upon delivery and for real property means upon registration of the deed of transfer.

The *liability* for the estate and inheritance duty falls on the individual beneficiaries of the estate. The heirs or legatees are jointly and severally liable for the payment of the estate taxes, due on the decedent's property. For the gift tax it is the donee who is liable for the taxes that were levied.

2. *Determination, Valuation and Computation*

Taxation on the transfer of property by death or gift only takes place when the property in question is located within Italy. This applies to immovable as well as movable property. Movable and immovable property located outside Italy is not subject to this tax even when the deceased or donor lived in Italy. While stock and debentures of Italian corporations are always deemed to be property located in Italy, irrespective of the physical location of the securities, the stock and debentures of foreign corporations can only be considered as a part of the taxable property, if the securities are physically kept within the Italian territory.

The valuation of the estate assets are normally done at market value. Securities are valued at the current quoted price. The law also makes certain specific presumptions with regard to the existence of jewelry, money and household furniture. Property transmitted by reason of death is presumed to include, first, jewelry and money to the amount of 2% of the gross value of the rest of the property of the decedent; and second, household furniture to the amount of 5% of the total gross value of the estate, including money and jewelry already assessed in the presumptive way.

Debts may be deducted from the taxable estate, but only if they are evidenced by a written contract or because they are entered in a commercial balance sheet. As the foreign situs property is not taxed at all, the debts related to a foreign situs property cannot be deducted.

Deductible expenses which are allowed include expenses on account of the last illness of the decedent. Funeral expenses are limited to Lire 40,000. The tax on the aggregate value of the estate is also deducted from the value of the estate before the distribution of the shares of the estate.

The market value is also taken into account in the valuation of business enterprises and partnership interests.

3. *Exemptions and Deductions*

Transfers of certain assets of the estate are not subject to the inheritance tax or gift tax, regardless of the beneficiary. The exemptions are specified by the law and cannot be extended to other cases by analogy.

Exempted are, first of all, art collections. This exemption, however, terminates if the collection is sold within a decade of the death of the decedent. Exempted are, secondly, transfers of certain securities of public debt, either in the form of loans or in the form of consolidated annuities or treasury bonds. Thirdly, bequests and gifts to religious and welfare institutions are exempted from the progressive rate and taxed at a flat rate of 5%. That transfers of motor vehicles at death are subject only to a special tax, instead of inheritance and estate taxes, is not an exemption, but a different method of taxation.

A deduction of 50% of the *estate tax* on the part of the estate that falls to ascendents and descendents or the surviving spouse is normally allowed. The estate tax is not due at all when the the total estate has a value which is lower than Lire 3,000,000 (= $480) when the estate goes to ascendents, descendents or a surviving spouse. If the estate goes to other heirs than the above, no estate duty has to be paid when the estate value does not exceed Lire 500,000.

Deductions of the estate tax are also allowed when the transfer takes place more than once in a stipulated time period. If the estate property is transferred twice within two years, the rate of the estate tax for the second transfer is reduced by 50%. If the estate is transferred from parents to five children or more, the estate tax on the first Lire 20,000,000 is reduced by 75%. For the inheritance tax a tax free deduction of Lire 750,000 is allowed for parents, children and the surviving spouse. As has been mentioned already, the estate tax paid by the beneficiary can be deducted as an

expense from the inheritance tax that has to be paid.

4. *Rates and Method of Calculation*

The *estate tax* is calculated on the value of the entire estate. The tax is then levied on each heir, according to the percentage of the total estate he receives. The rates of the estate tax, which have been in force since May 31, 1949, are progressive according to the value of the estate. There also is a surcharge of 10% which increases the rates to a total rate which is a tenth higher. All this is shown in Table XIX.

Unlike the estate tax, which is applied to the estate as a whole, the *inheritance tax* is levied and computed separately on the distributive share of each of the heirs or legatees by way of progressive rates. The law distinguishes between five categories of beneficiaries:

I direct line ascendents and descendents, including legally recognized natural children;
II spouses;
III brothers and sisters;
IV uncles, aunts, nephews, nieces; and
V great-uncles, great-aunts, great-nephews, great-nieces, cousins, other relatives beyond 4th degree, persons related by marriage and strangers.

TABLE XIX

Rates of the Estate Tax in Italy
(in percentage)

Aggregate net value (in Lire) From	To	Rate of Tax %	Surcharge %	Total Tax %
0	1,000,000	1	10	1.1
1,000,000	2,500,000	2	10	2.2
2,500,000	5,000,000	3	10	3.3
5,000,000	10,000,000	6	10	6.6
10,000,000	15,000,000	9	10	9.9
15,000,000	25,000,000	12	10	13.2
25,000,000	50,000,000	16	10	17.6
50,000,000	75,000,000	20	10	22.0
75,000,000	100,000,000	25	10	27.5
100,000,000	250,000,000	29	10	31.9
250,000,000	500,000,000	32	10	35.2
500,000,000	and more	35	10	38.5

The rates for the different classes are listed in Table XX. There also is a surcharge on all rates of 10%.

TABLE XX

Rates of the Italian Inheritance Tax
(in percentage)

Taxable value of inheritance (in Lire) From	To	% rate by Category I	II	III	IV	V	Surcharge
0	1,000,000	1	2	3	5	15	10%
1,000,000	2,500,000	2	3	5	8	20	10
2,500,000	5,000,000	3	4	8	12	25	10
5,000,000	10,000,000	6	8	16	19	40	10
10,000,000	15,000,000	9	12	22	25	46	10
15,000,000	25,000,000	12	16	28	32	52	10
25,000,000	50,000,000	16	20	34	41	60	10
50,000,000	75,000,000	20	25	41	51	70	10
75,000,000	100,000,000	25	30	48	60	74	10
100,000,000	250,000,000	29	34	54	64	77	10
250,000,000	500,000,000	32	37	57	67	79	10
500,000,000	and more	35	40	60	70	80	10

Gifts are taxed in the same way as inheritances i.e. they are taxed twice, first by an "estate tax", then by an "inheritance tax". If a gift is made, and subsequently the donee becomes the heir or legatee of the donor, the gift is included in the taxable inheritance for the gross amount and previously paid taxes on the gifts are credited against death taxes. Thus the progressiveness of the death taxes cannot be avoided by previous gifts.

LUXEMBURG

1. *Summary — Types of Tax and Tax Liability*

The inheritances are charged either with a succession or transfer duty (droit de mutation par deces). The *succession duty* is levied, if the decedent is a resident of Luxemburg, on all property except real property abroad. The transfer duty is only levied if the decedent is a non-resident on real property situated in Luxemburg.

There also is a *gift tax*. It is payable in respect of real estate in Luxemburg, no matter where the gift was made, but a gift of transferable securities is not chargeable unless it was made by deed delivered in Luxemburg. Gifts delivered by hand are not chargeable.

Luxemburg also levies an *estate duty* payable on the whole estate of persons who were domiciled or habitually resident in Luxemburg. Property passing in direct line or between spouses who have children or descendents is exempt from estate duty but not from duty on transfer by death.

The succession duty is due, after the deduction of the decedent's debts, and only if the net active exceeds the sum of 20,000 L.F. (= $400). For the transfer duty no deduction of costs is allowed, whatever is the declared value.

2. *Rates and Method of Calculation*

Everything received in the direct line is exempted from succession duties. The inheritor in the direct line who, by a special disposition made at the time of death, receives grants he would not have acquired were it not for the special disposition referred to, has to pay the following duties:

(a) on the portion of the goods which a person, who has ascendents or descendents in the direct line, could legally dispose of by way of testament, 2.5%;

(b) on the surplus, except the part inherited legally and without the deduction of charges other than the debts at the time of death, 5%.

These dispositions are applicable in case of grandchildren and other descendents, when they are inherited from their elders and their parents are still alive. The duty is not due for an amount equal to the part received by their father or mother when they inherit without the existence of a testament.

Between spouses without children, the surviving spouse is liable for a duty of 6% on the goods inherited from the decedent spouse.

For brothers and sisters:

(a) on the part received without a testament, 6%;

(b) on the rest, 15%.

Inheritance in favour of public establishments, hospitals, etc., 6%.

Between nephew or niece, aunt or uncle, the part acquired without the stipulation of a testament is charged at 10%, the rest at 15%. For other relatives and non-relatives, the general duty amounts to 15% on everything they receive.

These rates are applicable if the inheritances are not worth more than 100,000 F. For the amounts above 100,000 F the following majorations are provided for:

Inheritance (in francs)		Majorations
from	to	
100,000	200,000	1/10
200,000	300,000	2/10
300,000	400,000	3/10
400,000	500,000	4/10
500,000	750,000	5/10
750,000	1,000,000	6/10
1,000,000	1,500,000	7/10
1,500,000	2,000,000	8/10
2,000,000	2,500,000	9/10
2,500,000	3,750,000	12/10
3,750,000	5,000,000	13/10
5,000,000	6,250,000	14/10
6,250,000	7,500,000	15/10
7,500,000	8,750,000	16/10
8,750,000	10,000,000	17/10
10,000,000	12,500,000	18/10
12,500,000	15,000,000	19/10
15,000,000	17,500,000	20/10
more than	17,500,000	22/10

The transfer duty is fixed at 2% in the direct line and at 5% for spouses with children. For the other inheritors the rates are the same as for the succession duty. If the value of the real property acquired by each beneficiary is more than 100,000 L.F., the same majorations apply

THE UNITED KINGDOM

1. *Summary — Types of Tax and Tax Liability*

The U.K. system is different from the other European countries discussed in that only an *estate tax* and no gift tax exists.[1] The estate duty is due at the death of an individual who is domiciled within the U.K. at the time of his death or who, not being so domiciled, owns real or personal property situated within the U.K.

It is the personal representative of the deceased who is liable to pay the estate duty from the estate funds in respect to all personal property, wherever situated, of which the deceased was competent to dispose at his death. As regards all other property on which the executor is not liable to pay the estate duty, the trustees, beneficiaries and alienees are liable.

[1] Apart from a 1% stamp duty on certain transfers of property.

2. *Determination, Valuation and Computation*

Estate tax is payable on the principal value of all real or personal property, whether "settled or not settled", which "passes" on death. The reference to "settled property" is important as it has the effect of subjecting to estate tax many interests in property which might otherwise be considered to be outside the scope of the tax. Property is "settled" if its enjoyment is limited to several persons in succession, as where a trust is created to pay the income to A for life and distribute the principal to B upon the death of A, or where property is held on a life estate or on an estate for the life of another. This means that not only the property which the decedent was competent to dispose of at the time of his death will be taxed, but also property in which the deceased or any other person has an interest ceasing on the deceased's death.

There also are a number of provisions designed to prevent the avoidance of estate tax liability by means of inter vivos transfers in anticipation of death or by means of other hidden transfers. As the U.K. does not have a gift tax, these provisions are very important. The law states that gifts made by the deceased within five years preceding his death, as well as gifts of more than £500 made in contemplation of death, are considered as property deemed to pass on death. A gift thus included in the estate is evaluated not at the time of the gift but at the time of the death of the donor.

The regulations are also quite severe for gifts with a reserved interest, life insurance policies and transfers to controlled operations.

(a) Any gift, whenever made, which is not to the entire exclusion of any benefit to the donor, is includible in his taxable estate unless his interest terminated more than five years before the date of death.

(b) An insurance policy, which is owned by the decedent at the time of his death, or which was given away within five years of death, or which was given away at any time subject to retention of any benefits, would be included in the taxable property.

(c) In the case of a transfer to a corporation, which was controlled by not more than five persons at any time between the date of transfer and the date of death and from which the decedent has received any benefits within the five years preceding his death, a portion of the corporation's assets may be deemed to have passed at his death.

Property is normally valued at the price which it would bring upon sale on the open market at the time of death of the deceased. Shares and securities which are quoted on a public stock exchange are valued at the closing bid price plus one fourth the difference between that price and closing asked price. Unlisted shares and securities are valued by taking into account anticipated dividend yield, future earnings, etc.

3. *Exemptions and Deductions*

Exempted from estate tax or provisions which have the effect of an exemption are the following:

(a) An estate which has a value lower than £5,000;

(b) Real property and immovable property situated outside Great Britain;

(c) Movable property situated outside Great Britain if the deceased owner was domiciled outside Great Britain at the time of death;

(d) Land and buildings used for industrial purposes, machinery and equipment and agricultural property are subject to a special scale of rates. As they are included at only 55% of their value this provision amounts to an exemption of 45%.

(e) Business assets and bonds which pass on two successive deaths within a 5 year period are subject to a reduced scale of rates in the second estate, which has the effect of exempting 10 to 50% of the value of the property from tax on the second death.

(f) Objects which are of national; scientific, historic or artistic interest.

(g) Certain U.K. government securities held by persons not normally domiciled or not ordinarily resident in the U.K.

Reasonable funeral expenses and any debts incurred by the deceased may be deducted. No deduction is allowed for the cost of administration when the property is

located in the U.K. If the property is located outside the U.K. a deduction up to 5% of the value of the property can be allowed for. Remarkable is the absence of any exemption for charitable bequests by will. The impact of the rule that gifts given within 5 years before the time of death are taken up into the estate is considerably diminished since 1960, because only the inclusion of 85% of the gift in the third year before death, 70% in the fourth year and 40% in the fifth year is required.

TABLE XXI

Rates of Estate Duty in Great Britain (in %)

(April 3, 1963)

Value of Estate (in £) from	to	Normal Rate (%)	Rate on Agricultural and certain industrial property, plant and machinery (%)
up to	5,000	0	0
5,001	6,000	1	0.55
6,001	7,000	2	1.10
7,001	8,000	3	1.65
8,001	10,000	4	2.20
10,001	12,500	6	3.30
12,501	15,000	8	4.40
15,001	17,500	10	5.50
17,501	20,000	12	6.60
20,001	25,000	15	8.25
25,001	30,000	18	9.90
30,001	35,000	21	11.55
35,001	40,000	24	13.20
40,001	45,000	28	15.40
45,001	50,000	31	17.05
50,001	60,000	35	19.25
60,001	75,000	40	22.00
75,001	100,000	45	24.75
100,001	150,000	50	27.50
150,001	200,000	55	30.25
200,001	300,000	60	33.00
300,001	500,000	65	35.75
500,001	750,000	70	38.50
750,001	1,000,000	75	41.25
over	1,000,000	80	44.00

4. *Method of Calculation and Rates*

The duty is calculated on the net value of the entire estate, i.e., the value of the estate less the debts and funeral expenses. The degree of family relationship between the deceased and the inheritors is of no importance here, since the duty is only a function of the value of the estate.

Table XXI shows the progressive rates which are levied. These rates apply to the total taxable estate and not only to the amount which exceeds the preceding bracket. However, in order that an estate which is only slightly greater than the upper limit of an estate tax subject to the next lower rate, will not be reduced by the tax below the net amount which would remain from an estate at the top of the next lower level, "marginal relief" is provided. The marginal relief limits the tax to the amount corresponding to the previous bracket plus the total amount by which the estate exceeds the previous bracket. If a man died with an estate of exactly £100,000, the rate of duty would be 45%, i.e., £45,000, whereas if he died with an estate of £100,010, the rate would theoretically be 50% which would bring the duty to £50,005. The marginal relief provision, however, allows £100,000 to be taxed at 45% to which £10 should be added. This would bring the total tax to £45,010 instead of £50,005.

AUSTRIA

1. *Summary — Types of Tax and Tax Liability*

Austrian law makes a difference between the death duty ("Erbschaftsteuer") and gift duty ("Schenkunsteuer"). The *death duty* is due under three circumstances: first of all when a resident individual[1] dies and leaves taxable property wherever situated to another individual or legal person (resident or non-resident); secondly, when a resident individual or legal person receives taxable property wherever situated from a decedent (resident or non-resident); and, thirdly, when both the decedent and the beneficiary are non-residents, but property is situated in Austria at the time of death. Austria also has a death duty equivalent for legal persons on the basis of the total property of the legal person ("Erbschaftsteuer-equivalent").

The *gift duty* is due under the same circumstances, except that here the taxable event is a gift

[1]A person is still considered a resident of Austria when he leaves Austria for a period of less than two years.

made by an individual or legal person to another individual or legal person.

There is no problem to determine the liability for the death duty as this is with the beneficiary. For the gift duty the person who is liable is the one indicated in the agreement. If no party is specifically designated, then both the donor and the donee are jointly liable for this duty.

2. *Determination and Computation*

To determine what property will be taxed the residential status of the decedent and beneficiary and the location of the property have to be considered.

If the decedent is a resident of Austria, all property (real or personal, tangible or intangible) situated in or outside Austria, which passes at the time of his death, is subject to the death duty. If it is the beneficiary who is a residen of Austria, duty has to be paid on all property he receives. If neither the decedent or the beneficiary are resident of Austria, all real, agricultural and industrial property (tangible or intangible) situated within Austria is subject to the death duty.

The same rules apply for the gift duty except, of course, that the taxable event is a gift made by an individual or legal person to another individual or legal person.

As for the computation, the Austrian death duty is levied separately on the value of the property received by each beneficiary. For the purpose of establishing the progressive rate, one includes in the property received all gifts made in the previous 10 years by the same donor. If the duty on these earlier gifts has already been paid, a credit is allowed for. Costs, like funeral expenses, debts of the decedent and foreign estate taxes are duductible from the estate before computing the taxable basis in the hands of the recipients. The value of the property acquired is the market value at the time of death.

The gift duty is also levied on the market value of a particular gift that each beneficiary receives. Also for the purpose of establishing the progressive rate, included in the property received are all gifts made in the previous 10 years by the same donor. A credit, however, is given for the gift duties already paid.

3. *Calculation Method and Deductions*

The Austrian system distinguishes between five classes of beneficiaries. The death and gift duty vary progressively with the particular class in which the beneficiary or donee falls.

These five classes are:

Class I — the spouse and the children of the decedent or donor;

Class II — the descendents of the children of the decedent or donor;

Class III — the brothers and sisters of the decedent or donor;

Class IV — the children of the brothers and sisters of the decedent or donor, and the parent-in-law and children-in-law of the decedent or donor; and

Class V — other individuals as well as legal entities.

TABLE XXII

The Rates for Death and Gift Duties in Austria

(in percentage)

Taxable base (in Austrian shillings)	Taxable Class (%) I	II	III	IV	V
50,000	2	4	6	8	14
100,000	2.5	5	7.5	10	16
200,000	3	6	9	12	18
300,000	3.5	7	10.5	14	20
400,000	4	8	12	16	22
500,000	5	10	15	20	26
750,000	6	12	18	24	30
1,000,000	7	14	21	28	34
1,500,000	8	16	24	32	38
2,500,000	9	18	27	36	42
5,000,000	10	20	30	40	46
7,500,000	11	21	32	42	48
10,000,000	12	22	34	44	51
20,000,000	13	23	36	46	54
30,000,000	14	24	38	48	57
excess	15	25	40	50	60

The rates given in Table XXII apply to the taxable base and not only to the amount which exceeds the preceding bracket. If, for example, an individual falls under Class I and the taxable base is 1,000,000, the 7% rate applies on this whole

amount. For the individuals in Class I and II a deduction is provided for the first 10,000 Austrian shillings ($385) which are not taxed. It is, however, necessary that the beneficiary (or donee) or decedent (or donor) are Austrian residents. If neither of these parties are residents of Austria and they receive taxable property situated in Austria, no deductions are allowed.

The death duty equivalent is levied at a rate of 0.5% and is payable every year. The part of a corporation's net worth owned by individual shareholders is exempted if it is 10% or more of the total net worth of the corporation. If the total value is less than 40,000 Austrian shillings, no tax is levied.

SWEDEN

1. *Summary — Types of Tax and Tax Liability*

From 1948 to 1958 Sweden had a succession, an estate, a gift tax and an "estate tax on gifts". As of January 1, 1959, the estate tax, which had taxed the estate as a whole before the succession duty was levied on the amount of each individual beneficiary's inheritance, was repealed and replaced by only one succession and gift tax. From that time the succession duties were increased to avoid a loss of revenue.

The *succession tax* is payable on the receipt of property, whether located in Sweden or abroad, left by a person who at his death was either a resident or citizen (resident or not) of Sweden. A person is considered a resident if at the time of his death his "real dwelling and home" were located in Sweden, or if he was making a "permanent sojourn" in Sweden at the time of his death. Apart from this general rule, certain types of property deemed to be of Swedish situs are charged with a succession or gift duty, regardless of the citizenship or residence of the transferor or recipient. These types of property are listed below under point 3.

The *gift tax* is due by a donee who is a citizen of Sweden, a resident of Sweden (including an alien resident), or a Swedish juridical person, whether the gift is in property located in Sweden or abroad. As with the succession duty the list given under point 3 below indicates that a donee who is in none of the above categories may still be taxable if he receives property which is thus deemed to be of Swedish situs.

For both the succession and gift duty the liability is imposed on the beneficiary. As has been stated the beneficiary is taxed on his individual share of the estate for the succession duty. In practice, the tax is paid out of estate funds by the administrator, who deducts this amount from the beneficiary's share. If the total tax arising from the settlement of an estate is not paid, each individual beneficiary may be held liable for its payment up to the value of the property he has received.

A basic feature of the Swedish succession tax system, essential in an understanding of some of its other provisions, is the fact that, in certain circumstances, liability for the tax may be postponed. Since the tax is laid on the receipt of property by the beneficiary, the law provides that in described circumstances where enjoyment of the legacy is postponed for a period after the decedent's death, liability for the tax may likewise be postponed. Because postponement of liability normally requires postponement of valuation it may be that the tax that will have to be paid will eventually be higher. Therefore the option to make the payment immediately on the basis of present value is often advantageous.

2. *Determination, Valuation and Computation*

In the case of decedents who are Swedish residents or citizens, the value of all property of the decedent that passes, regardless of location, is taxed. If the decedent is neither a resident nor a citizen of Sweden, the tax is levied upon transfer of certain types of property deemed to have its situs in Sweden. These types of property are:

(a) real property in Sweden, or the right to receive rents or other benefits from such property;

(b) assets of a Swedish business, including machinery and equipment, inventories and raw materials; or the capital of such a business in the form of cash, securities, or shares in corporations, or the right to use or enjoy any such property;

(c) shares in Swedish corporations, or interests in Swedish partnerships.

The same rules apply to the gift tax provisions. The above types are also deemed to have their situs in Sweden, even if the donee is neither a Swedish citizen, resident or Swedish juridical person.

Valuations are based on conditions at the time when the liability to pay the tax becomes fixed. Ordinarily this is the date of death. Where liability to the tax may be postponed, valuations are based on conditions at the time the property comes into possession or enjoyment and the tax becomes due.

Real property is valued at its assessed value for the year prior to the year in which death occurred. Listed securities are valued at the quoted price, provided that it is equivalent to the price that would be received at a sale under normal conditions; if it is not, the latter value rules. Unlisted securities are valued at the price that a sale under normal conditions would bring. This is, in practice, usually equivalent to the most recent value shown for purposes of the net wealth tax, if such is available. There also is the general provision that movable property shall be taxed at the value which it would bring at a sale undertaken with due care but occasioned by the liquidation or winding up of the estate. Approximately the same valuation rules are made for the gift taxes.

3. *Exemptions and Deductions*

The rule that, in the absence of any agreement between the spouses to the contrary, one spouse acquires an undivided half interest in the property of the other, has a considerable impact on the application of the succession duty. No succession tax is levied on the value of property received by a surviving spouse to the extent that it does not exceed the value of his or her half interest in the common marital property. This is not considered as an exemption because what the surviving spouse receives on account of his marital right is regarded merely as the vesting of what was his or hers already.

Over and above the value of this common marital property, the surviving spouse is not taxed on any legacy which does not exceed S. Kr. (Swedish Krone) 40,000. If the spouse's share exceeds that figure, the entire amount is taxable and not only the amount above S. Kr. 40,000.

The share of children is not taxed if its value does not exceed S. Kr. 6,000. If a child is under 21 years of age at the time of his parent's death, the tax-free amount is increased by S. Kr. 2,000 for each year by which the child's age is less than 21 years. In the case of brothers, sisters and parents, the tax-free amount is S. Kr. 2,000. For all other legatees the tax-free amount is fixed at S. Kr. 1,000. The general rule that, when the amount of the inheritance exceeds the exemption the total inheritance is taxable, does not apply to the case of children. Only the amount that exceeds the exemption is taxable for them.

The proceeds from life insurance policies are generally subject to the succession tax in the hands of the beneficiary. There are, however, a number of qualifications to this general rule.

(a) The first S. Kr. 25,000 of the proceeds of such insurance to each beneficiary is exempt, provided that the policy may not be subjected to the payment of the decedent's debts.

(b) Any pension received as the result of insurance taken out in connection with employment remains exempt from the succession duty. Moreover any pension received as the result of an insurance policy which, even though not taken out in connection with employment, was more than 10 years old at the date of death is exempt. As to the proceeds of pension insurance not taken out in connection with employment and not more than 10 years old, the value of any recipient's right to the pension is taxable only to the extent that the pension exceeds S. Kr. 10,000 per year.

(c) The value of annuities paid on account of insurance which fails to qualify as pension insurance is tax-free to the extent that the annual payment does not exceed S. Kr. 2,500 per year. The amount of the annual payment exceeding this sum is capitalized and subjected to the succession tax.

The major exemptions for the gift tax are S. Kr. 2,000 from any one donor to the donee. If the gift exceeds this amount, the entire sum, not just the

excess over S. Kr. 2,000, is taxable. Inter vivos gifts of furniture and interior chattels intended for the personal use of the donee or his family are exempt from the gift tax, although such a transfer on death is taxable. Gifts for the purpose of the donee's education or upbringing are exempt if it can be shown that the donee cannot reasonably expect such benefits from other sources. This latter provision is in fact a tightening of the pre-1959 arrangements, as it was considered as presenting too many loopholes for evasion.

Deductions to compute the taxable amount allowed for the succession duty are the decedent's debt and funeral expenses and the cost of preparing the inventory. All other administration costs and the death duty itself are not deductible. There are no major deductions for the gift tax.

TABLE XXIII

Rates of Succession and Gift Taxes in Sweden
(Law of January 1, 1959)

Value in S.Kr. of Recipient's Amount		Class I		Class II		Class III		Class IV	
from:	to	Amount of Tax on Low Figure of the bracket S.Kr.	Plus % of Amount Exceeding Low Figure of bracket %	S.Kr.	%	S.Kr.	%	S.Kr.	%
1,000	2,000	0	0	10	0	40	10	200	20
2,000	3,000	20(1)	1(1)	60	6	140	10	400	20
3,000	4,000	30(1)	2(1)	120	6	240	15	600	20
4,000	5,000	50(1)	2(1)	180	6	390	15	900	20
5,000	6,000	70(1)	2(1)	240	9	540	15	1,000	30
6,000	10,000	90	3	330	9	690	20	1,300	30
10,000	12,000	210	3	690	12	1,490	20	2,500	40
12,000	15,000	270	4	930	12	1,890	20	3,300	40
15,000	20,000	390	4	1,290	15	2.490	20	4,500	40
20,000	30,000	590	5	2,040	20	3,490	25	6.500	50
30,000	40,000	1,090	6	4,040	25	5,990	25	11,500	60
40,000	50,000	1,690	7	6,540	30	8,490	25	17,500	60
50,000	60,000	2,390	8	9,540	35	10,990	25	23,500	65
60,000	70,000	3,190	9	13,040	35	13,490	30	30,000	65
70,000	75,000	4,090	10	16,540	35	16,490	30	36,500	65
75,000	80,000	4,590	10	18,290	40	17,990	30	39,750	65
80,000	90,000	5,090	15	20,290	40	19,490	30	43,000	65
90,000	100,000	6,590	20	24,290	40	22,490	30	49,500	65
100,000	150,000	8,590	24	28,290	45	25,490	30	56,000	65
150,000	200,000	20,590	28	50,790	50	40,490	30	88,500	65
200,000	300,000	34,590	32	75,790	55	55,490	30	121,000	65
300,000	400,000	66,590	36	130,790	55	85,490	30	186,000	65
400,000	500,000	102,590	40	185,790	55	115,490	30	251,000	65
500,000	1,000,000	142,590	44	240,790	60	145,490	30	316,000	65
1,000,000	2,000,000	362,590	48	540,790	65	295,490	30	641,000	65
2,000,000	5,000,000	842,590	52	1,190,790	65	595,490	30	1,291,000	65
5,000,000	. . .	2,402,590	60	3,140,790	65	1,495,490	30	3,241,000	65

4. *Rates and Method of Calculation*

After the deductible expenses of the estate are subtracted from the estate, each beneficiary's or donee's share is determined in order to levy the tax on the share of each of them.

The rates for the succession and gift tax are the same. The beneficiaries, however, are divided into four separate classes with a special progressive rate applicable to each class. The progressiveness of the tax depends upon the degree of relationship and the amount transferred.

Class I beneficiaries consist of the surviving spouse, children, stepchildren or descendents of children or stepchildren.

Class II consists of two separate groups of taxpayers. The first group is composed of parents and stepparents, brothers and sisters, the descendents of brothers and sisters, half brothers and sisters and the surviving spouse of a child. The second group consists of household servants who have been employed for at least 10 years by the decedent or by a Class I or Class II relative of the decedent.

Class III beneficiaries consist of certain nonprofit institutions. The main criterion is that no special benefit accrues to the decedent (or donor) or members of his family by virtue of the transfer. The rules of eligibility are somewhat more liberal for purposes of inter vivos gifts than for legacies.

Class IV beneficiaries are all those not included in one of the above Classes.

Table XXIII is an unofficial compilation and extension of the four separate tables published by the Swedish Government. In using the table, start with the amount of each individual inheritance or gift. As has been mentioned above for inheritances by children only the excess over the exemption is charged, while for all other recipients the entire amount is taxed if it exceeds the exemption.

SPAIN

1. *Summary — Types of Tax and Tax Liability*

It should be stressed that the system of death and gift taxes in Spain is, in fact, a combination of a tax imposed on the total net estate left by the decedent (as in England) and an inheritance tax levied with respect to each acquisition by heirs or legatees (as in most European countries).

The *estate tax* ("Impuesto sobre el caudal relicto") is due when a resident or non-resident person decedent leaves property situated within Spain.[1] The inheritance tax ("Impuesto de derechos reales sobre la trasmision de bienes") is due under the same circumstances as the estate tax.

There also is a *gift tax* ("Impuesto sobre donaciones") due when an individual or legal entity makes a "perfect" gift to another individual or legal entity. The requirements for a gift are different according to whether the property involved is movable or immovable.

In the case of movable property the formalities that have to be fulfilled are few in number and rather insignificant. There are no particular requirements for a gift made in hand, if the other party accepts. For gifts which are made in a written document, the acceptance by the donee has to be done in written form. No certification by a notary is required, however. For immovable property, the acceptance has to be stated by a written document authorized by a notary.

2. *Determination, Valuation and Computation*

The rules of determination of what property is taxable is the same for the estate, inheritance and gift taxes. All the property located within Spain and forming part of the decedent's estate or donor's gift is taxed (movable, immovable and intangible property). Movable property left by a Spanish national, or acquired by a Spanish national, if it is located outside Spain is also taxed.

For the computation of the estate tax it is the custom to increase the value of the property, as declared by the tax authorities, by 2% for household furniture, except when the value declared for this furniture is higher than 2% of the value of the property. In that case, the total amount of the property, including the evaluation for household furniture, is decreased by:

[1] This situs rule is used in a large sense, as the relevant statutes provide that moveable property left to a Spanish citizen or acquired by a Spanish citizen is deemed to be situated in Spain, no matter where such property is actually located.

(a) the amount of mortgages or taxes and debts on the total property, as far as those are deductible for the inheritance tax (see below); and
(b) the total value of the property received by the exempted heirs (see below, under calculation method).

The inheritance tax is computed in the same way as the estate tax except that the allowed deductions are made explicit by the law. They are:
(a) outstanding debts of the decedent;
(b) unpaid taxes of the decedent;
(c) monetary fines against the decedent;
(d) expenses for protection of the estate; and
(e) last illness and funeral expenses.

It is important to mention that the estate tax which has to be paid can be deducted from the base for the inheritance tax.

TABLE XXIV
Rates for the Estate Taxes in Spain
(in percentage)

Value of net estate (in pesetas) From	To	Basic %	Surcharge
0	2,000	0	15
2,001	10,000	1	15
10,001	50,000	2.25	15
50,001	100,000	3.25	15
100,001	250,000	4.25	15
250,001	500,000	5.50	15
500,001	1,000,000	6.75	15
1,000,001	2,000,000	8	15
2,000,001	3,000,000	9	15
3,000,001	5,000,000	10	15
5,000,001	10,000,000	12	15
10,000,001	20,000,000	13	15
20,000,001	50,000,000	14	15
more than	50,000,000	15	15

For the gift tax a distinction is made between ordinary and onerous* gifts as well as gifts for remuneration. From the value of ordinary gifts, certain charges, such as mortgages and pledges are deductible. From onerous gifts, the amount of the services rendered or the expenses incurred by the donee are deductible. As for the gifts for remuneration (e.g. where the donor offers his home as a gift to the donee, and the donee gives certain remuneration to the donor in return), the taxable income is the difference between the value of the donated property and the total amount of the remuneration made to the donor.

Table XXV
Rates of the Spanish Inheritance Taxes
(in percentage)

Value (in Pesetas) From	To	Children	Grand Children	Spouse	Non-Relatives
0	1,000	0	0	0	47
1,001	10,000	0.1	0	0	49
10,001	50,000	3.5	7	5.5	50
50,001	100,000	6.1	8	6.5	51
100,001	250,000	6.51	8.5	7	52
250,001	500,000	7.25	9	7.5	54
500,001	1,000,000	7.75	9.51	8	55
1,000,001	2,000,000	8.25	10.25	8.5	56
2,000,001	5,000,000	8.75	10.75	9	57
5,000,001	10,000,000	10	12	11	60
10,000,001	20,000,000	11	13	12	62
20,000,001	50,000,000	12	15	13	63
50,000,001	100,000,000	13	16	14	64
more than	100,000,000	15	18	15	66

TABLE XXVI
Rates of the Spanish Surtax for Inheritances
(in percentage)

Value (in Pesetas) From	To	Children	Grand Children	Spouse	Non-Relatives
up to	10,000	0	0	0	0
10,000,000	25,000,000	7	9	8	15
25,000,001	50,000,000	8	10	9	16
50,000,001	100,000,000	10	12	11	18

3. *Calculation Method and Exemptions*

Table XXIV shows the rates applied to the value of the net estate. Apart from the basic rate given in the table, there is a surcharge which increases the basic rate by 15%. Exemption of the estate duty depends on the categories of beneficiaries entitled to the estate. The basic rule of this complicated system is that the total tax due on the taxable estate is equally divided by the number of heirs. As this system would lead to unjustified tax charges for those who acquire only a small amount, the law states that the tax payable by these heirs can never exceed a certain maximum,

* (Editor's note) — more commonly referred to as "gifts with strings attached".

depending upon the case. A distinction is also made between various groups of heirs. The parts inherited by the spouse, parents and descendents are always exempt.

Table XXV shows the rates applied for the inheritance tax. The Spanish state also levies a surtax for inheritances (not for gifts) when the value is higher than 10 million pesetas.

The percentages are given in Table XXVI. The tax paid on the previous amount is deducted in imposing this surtax. As with the estate tax there also is a surcharge of 15% which is imposed both on the succession and the gift duties.

PORTUGAL

1. *Summary — Types of Tax and Tax Liability*

Portugal levies an inheritance and gift tax. The *inheritance tax* is levied upon transfer by testate and intestate succession of property located in Portugal, or deemed to be located in Portugal.

The *gift tax* is due upon the gratuitous transfer inter vivos of property located in Portugal or deemed to be located in Portugal. The gifts become taxable when perfected. A gift of movable property by verbal statement is perfected upon delivery. Gifts by means of a written statement must have an acceptance signed by the donee in order to be perfected. Gifts of real property must be made by written instrument and have the donee's acceptance signed thereon.

The recipients of the property i.e. heir or legatee or donee are liable for the payment of the inheritance tax, irrespective of their residence in or outside the country. If the recipients cannot be made to pay, because they cannot be prosecuted outside Portugal or for other reasons, the property may be sold to pay the tax.

2. *Determination and Computation*

To determine what kind of property is taxed for inheritance and gift tax, the law enumerates the following types to specify the general rule that tax is levied, when property that is in, or deemed to be in, Portugal, is transferred. The types of property include:

(a) real or movable property physically in Portugal;

(b) motor vehicles, ships, airplanes and railway rolling stock registered in a Portuguese registry office; and,

(c) notes, stocks and bonds whose holder is domiciled in Portugal. In addition, regardless of the residence or domicile of the holder, certain types of property are deemed to be located in Portugal. Government bonds and shares of stock issued by corporations domiciled in Portugal are an example of this category.

The Portuguese inheritance tax is levied not on the estate as a whole but on the net amount received by each individual beneficiary. On each portion, after the applicable exemptions are deducted, the tax is then computed according to rates given in Table XXVII.

The basis of the tax is the value of the property received. If the recipient or the tax authorities so wish, they can ask to let the value of some types of property be determined by an appraisal by disinterested third parties. For shares of stock and bonds, currency, gold, silver and jewels, the right to lease or sublease property, and real estate, these appraisals by a neutral party cannot be resorted to.

Deductions which can be made from the total estate are debts of the decedent in general, previous and personal obligations, funeral expenses, amounts to cover litigations in progress, unpaid taxes and expenses of administering the estate. After the total value of the estate has thus been established, an additional amount is added for the presumed value of household furniture for specified amounts according to the value of the estate not including the furniture.

The gift tax is also computed on the amount received by each individual donee. Any liabilities assumed by the donee as a consequence of accepting the gift are deductible to arrive at the taxable amount of the gift.

3. *Calculation Method and Exemptions*

The rates of Table XXVII apply for the inheritance tax as well as the gift tax. The progression of the rates increases as the amounts and the remoteness of kinship between recipient and donor or decedent increase.

TABLE XXVII

Rates of Inheritance and Gift Taxes in Portugal
(in percentage)

Value (in escudos) From	To	Descen-dents	Ascen-dents	Spouses	Brothers and Sisters	Relations 3rd Degree	Non Relatives
1	5,000	0	9	10	11	17	26
5,001	20,000	0	11	12	13	19	28
20,001	100,000	3	13	14	15	21	30
100,001	250,000	5	15	16	17	23	32
250,001	500,000	7	17	18	19	25	36
500,001	1,000,000	9	19	20	21	27	36
1,000,001	2,000,000	11	21	22	23	29	38
2,000,001	5,000,000	14	24	25	26	32	41
5,000,001	10,000,000	17	27	28	29	35	44
10,000,001	50,000,000	21	31	32	33	39	48
over	50,000,000	25	35	36	37	40	52

The tax is then calculated by multiplying the least figure of the bracket by the next lowest percentage, and any excess by the percentage given in the bracket. If, for example, a beneficiary receives 150,000 escudos from his brother, he will have to pay 15% on 100,000 escudos and 17% on the remaining 50,000 escudos, which gives a tax of 23,500 (15,000 + 8,500 escudos).

A special reduction is provided for (both gift and inheritance tax) if the property is transferred often. If, for example, property has been transferred that had already been transferred in the 5 preceding years, tax on the second transfer is reduced by half.

APPENDIX III

INTERNATIONAL TAX TREATIES RE SUCCESSION DUTIES

Depending upon the rules applied by the individual countries about territoriality and residenceship, it occurs often that the same assets are taxed in two countries. To avoid this double taxation, a certain number of treaties have been concluded. In order to appreciate to what degree these treaties change the general rules discussed above, it would be necessary to study their contents.

Belgium concluded succession duty agreements with Sweden (1956), France (1959) and the U.S. (1954). The Netherlands has signed treaties with the U.K. (1948), Switzerland (1951), Sweden (1952) and Finland (1954). The above treaties only apply to succession and not to gift duties. A treaty amongst the Benelux countries promises mutual co-operation in the collection of estate and gift taxes, however.

Germany went into an agreement with Greece as early as 1910. It only applies to movable property of decedents who are nationals of one of the two countries. Other treaties exist with Switzerland (1931), Sweden (1935) and Austria (1954). These treaties exempt from German tax the property that is situated in the other contracting countries. In relating the rate appropriate for the taxable part of the transfer, the value of the exempted part is included.

Italy signed treaties with the U.S.A. (1935) and Sweden (1956), while the U.K. drafted a tax treaty with Eire (1927), the U.S.A. (1945), South Africa and Canada (1946), the Netherlands (1948), Switzerland and India (1956), Pakistan (1957), Sweden (1960), and France (1963).

The partners of Sweden were Germany (1935), France (1937), modified in 1949, Switzerland (1943), Norway and Finland (1950), Denmark and the Netherlands (1953). Austria concluded agreements with Germany and Switzerland (1954), France (1959), Luxemburg and Sweden (1962).

For all these countries the treaties have only relevance to the succession duties. The agreements concluded by France apply to the inheritance and the gift tax, however. France entered into treaties with Sweden (1937), U.S.A. (1946), Monaco (1950), Canada (1951), Switzerland (1953), Finland (1958), Lebanon 1962), Spain and the U.K. (1963).

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